(5)

No. 85-599

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

AMERICAN BAR ENDOWMENT

UNITED STATES OF AMERICA, PETITIONER

v.

FREDERIC D. TURNER, ET UX., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

JOINT APPENDIX

FRANCES M. GREGORY, JR.
Sutherland, Ashill & Brennan
1666 K Street, N.W.
Suite 800
Washington, D.C. 20006
(202) 872-7800
Counsel for Respondents

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217
Counsel for Petitioner

PETITION FOR WRIT OF CERTIORARI FILED OCTOBER 7, 1985
CERTIORARI GRANTED DECEMBER 2, 1985

3021PV

Volume II

TABLE OF CONTENTS*

* The opinion and judgment of the court of appeals, and the opinion and judgment of the Claims Court, are printed in the appendix to the petition for writ of certiorari and have not been reproduced here.

* * * * *

[813] THE COURT: Be seated. Sir?

MR. GREGORY: May we call another witness?

THE COURT: It's okay with me. That's what we're here for.

MR. GREGORY: Mr. Breiner, Your Honor.

THE COURT: Raise your right hand, please.

Whereupon,

RICHARD S. BREINER

was called as a witness by counsel for Plaintiff and, having been duly sworn by the Trial Judge, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. GREGORY:

Q. Preliminarily, Your Honor, I told Mr. Breiner that when I use the phrase, the years in issue, we were referring to the period July 1, 1978 through June 30, 1981. I would note that Mr. Breiner has been with the Endowment for some 26 years. I will try and be as precise as I can, if I am referring to time frames outside of the years in issue and I'm certain counsel for the United States will do the same.

I've asked Mr. Breiner, as has been our practice, to prepare a summary of his background, work experience and I'd ask him to give that to you at this time, together with [814] his full name and home address.

A. My name is Richard S. Breiner. I reside at 32 Arapahoe Drive, Thornton, Illinois. My work experience prior to 26 and a half years with the American Bar Endowment included, Akron Automobile Dealer's Association, Siberly Rubber Company, National Tire Dealer's and Retreader's Association, NURSICA, which was a home improvement association in New York.

I worked for the General Motor's Corporation in Cleveland, Ohio, as an expeditor in their diesel engine division. I worked for the United States Government as an

economist in the Rubber Division of OPA. I also worked for the government for three and a half years as a United States Marine. I think that about covers it.

Q. What was your educational background after high school, Mr. Breiner?

A. I went to Hammill College. That was a business university.

Q. Where was that located?

A. Akron, Ohio.

Q. When did you come to the American Bar Endowment?

[815] A. May 6, 1957.

Q. How did you come to know of a job opening at the endowment?

A. New York Life Insurance Company approached me and asked me if I might be interested in the opportunities with the Endowment.

Q. Who hired you to come to the Endowment?

A. The Treasurer of the American Bar Endowment, a gentleman by the name of Geider, Duke Gieder.

Q. When you arrived at the Endowment, were there any insurance plans in effect?

A. There was a life insurance program.

Q. It had been in effect for two years?

A. It started June 1, 1955.

Q. How many employees were at the Endowment in 1957?

A. There were no full time employees. There was a person that was borrowed from the American Bar Foundation who was an employee of the Foundation and there were two or three ladies from employment agencies that were working there.

Q. No permanent staff?

A. No permanent staff.

Q. When you came to the Endowment, were you informed of the charitable purposes of the insurance program?

[816] A. Yes, they advised me that the main purpose of the insurance programs was so that the participants might make the Endowment beneficiaries of their life insurance policy.

Q. This was 1957?

A. Yes.

Q. Do you know whether the intent of the program of having the Endowment or was it the Endowment or the Foundation designated as beneficiary of the insurance program?

A. I didn't understand the question.

Q. You stated that one of the purposes of the program was to have the Endowment designated as beneficiary. I'm simply asking you if you didn't mean to say the Foundation?

A. Foundation, yes, that's correct.

Q. Do you know whether that, in fact, came to pass in any large dollar amounts?

A. Not in any large dollar amounts, but still today there are certain benefits that the Foundation does derive. It took a long time for anything of that nature to develop.

Q. Do you know the level of the dividends on the life plan in 1957 when you came?

A. I don't believe there were any dividends.

Q. Do you know when the first dividend was?

A. I think it was 1958. The program started in June of '55, so a four years' premium really wasn't developed until June of 1956 and then it was very small. I don't think [817] anything developed til '58. If I recall, I received the first dividend on the program.

Q. Keep your voice up at the end of the sentence.

A. I believe I received the first dividend.

MR. GREGORY: Those amounts are stipulated, Your Honor.

BY MR. GREGORY:

Q. Mr. Breiner, at my request, have you attempted to determine what has been the total income to the Endowment, total receipts by the Endowment from dividends and experience credits over the last 25 years?

A. During the last 25 years, the Endowment has received in dividends and experience credits some $81,900,000.

Q. And, I also asked you to attempt to determine what the Endowment's expenses have been over the last 25 years. Did you make that calculation?

A. Yes, the expenses during that period time were around $18 million plus some dollars.

Q. And, did you determine how much the Endowment had made in grants in charitable activities in the field of law?

A. Yes, from those contributions, from the members we have made grants for the advancement of jurisprudence and administration of justice, nearly $63 million.

Q. Could you describe for me, in general terms, your function as an employee of the Endowment over the last 26-27 [818] years?

A. I work for a Board of Directors and my functions have always been to operate the Endowment as efficiently and effectively as possible through the direction of the Board of Directors.

Q. Does the Board operate through committees?

A. Yes, the Board has several committees.

Q. Would you enumerate the principle committees of the Board?

A. There is an insurance committee, an administration committee, policy committee and investment committee.

Q. Are you a member of any of those committees?

A. No, I am not.

Q. Is anyone a member other than a member of the Board of Directors?

A. No, sir.

Q. Do you have any vote on those committees?

A. No, sir. I have no vote on the Board either.

Q. Thank you. Let me direct your attention to the subject of insurance in the insurance committee. In matters pertaining to the Endowment's insurance programs, have you made comments, recommendations, et cetera, to the insurance committee or to the Board directly?

A. Any comments I might make would go through the [819] committee, it would go to the committee. I would not necessarily make any recommendations whatsoever to the Board of Directors.

Q. Who is the current president of the Endowment?

A. Kenneth Byrnes, Jr.

Q. Did he hold an office prior to being president?

A. Yes, he was vice-president. I think he held the vice presidency for two years before becoming president.

Q. I direct your attention now to the years in issue as we've defined it and could you please summarize the size of your office and the general functions of your staff?

A. During the years of issue we had upwards of 40-42 employees. Office-wise, we had approximately 10,000 square feet of office space. The staff, during those particular years we were moving into word processing and a terminal operation with data processing and we were in a training period along with doing the other functions of the office.

We had other things, other than insurance also. We have a grants program and we have investments and of course, there are numerous meetings. I don't know exactly how to explain the functions of 30-40 people.

Q. Let me ask you this. Could you tell us, in general, what functions your staff performed in support of the insurance programs of the Endowment?

[820] A. Well, we do the billings. We do the solicitations. We maintain the files of the participants of the insurance program. We verify claims that are presented. By that I mean, we ascertain that they are a member in good standing of the Association and that their premiums for that particular program are paid and we verify the benefits for that program.

We process applications to the extent of utilizing what the insurance companies refer to as a field manual.

Q. Is that the same thing as a screening guide?

A. Screening guide, right.

Q. Are there any other functions that you perform in aid of the insurance program?

A. Answer correspondence, inquiries regarding the programs.

Q. Is your office responsible for the preparation of brochures sent to members soliciting enrollment in the program of the endowment, insurance program?

A. Yes, sir, we prepare the solicitations.

Q. Let me direct your attention specifically to the solicitation material. Thinking of any piece of material, would you tell me who has to approve the document before it is forwarded to perspective insurers of the Endowment?

A. Well, the material is drafted and I approve the initial draft.

* * * * *

[835] BY MR. GREGORY:

Q. Mr. Breiner, are you a licensed broker?

A. Yes, sir.

Q. In what state?

A. Licensed in the state of Illinois.

Q. Do you perform any brokerage services in the state of Illinois or for any organization?

A. I am a broker and administrator on a life insurance program for the Chicago Bar Association.

Q. Is that done with or without the permission of the Board or the Endowment?

A. The Board is well aware of that activity.

Q. How large is that program?

A. It's a small progam. It had about $86,000. of annual premiums.

Q. Do you serve as broker for any other program?

A. No.

Q. Over the years, have you been asked to advise any organization setting up group insurance programs?

A. I've been requested by certain organizations to either look at their programs, give them my comments, or help them set up the group insurance program of one type or another.

* * * * *

[848] [Breiner – Direct] A. I do not know which individuals do the work, but it was done by the data processing center of the American Bar Association.

Q. And the letterhead on both exhibits is American Bar Association?

A. Right.

MR. GREGORY: Your Honor, we offer Exhibits 386 and 387 into evidence.

MR. MARKHAM: No objection, your Honor.

THE COURT: Admitted.

(Plaintiff's Exhibit 386 and 387 was received into evidence and made a part of the record thereof.)

MR. GREGORY: I might say, your Honor, that relevancy of this document become more apparent during the testimony of Ms. Ryerson.

BY MR. GREGORY:

Q. Mr. Breiner, were you familiar with a proposal by James Group Service in 1981 to take over Administrative functions for the insurance programs of the Endowment?

A. Yes, I reviewed that proposal.

Q. According to your understanding, how much of the insurance administration performed by the Endowment would James Group have taken over?

[849] A. They would have taken over all matters pertaining to the Administration Program.

Q. Would there have been any residual functions with regard to the insurance program retained by the Endowment staff?

A. There would be certain functions during the transition period that we would have to have staff to perform. Thereafter there would have to be some staff to do certain clerical work on behalf of the endowment, separate and apart from insurance programs.

Q. And what work would be separate and apart from the insurance program?

A. Well, we have a grants activities where money is allocated for grants. We have investment portfolios, we have a memorial fund. We would have a few people on staff, including myself, I would hope. So, there would always be Board meetings and committee meetings, and the insurance committee of the Endowment would still perform, more or less in the same fashion as they do today. They would approve promotional material and they would recommend to the Board of Directors any changes that might be necessary to take place.

* * * * *

[885] [Breiner—Cross] Q. Suppose that when such a dispute developed the member wrote to you or a member of your staff, informing you of the dispute and asking your help, did you ever receive such correspondence from members?

A. We received letters, which I'll categorize in the complaint family, that they have submitted a claim

sometime before, one thing or another, and they have not heard from the insurance company or they were not satisfied with the claim.

Q. In those instances, would you take the matter up with the insurance company?

A. Well, only to the extent of telling the insurance company that the member wasn't satisfied with the settlement. There is nothing we can do. We have never negotiated on behalf of any member and we so state that in the applications that we would not negotiate regarding underwriting or on any claims and we do not.

MR. GREGORY: What's the second one?

MR. MARKHAM: 2310.

BY MR. MARKHAM:

Q. Mr. Breiner, I've just handed you Exhibit 711-B and 2310. Can you identify these documents and state whether they're related?

A. Yes, I would—Exhibit 2310 is undoubtedly a [886] summary of the contents of Exhibit 711-B.

Q. What is the nature of the information contained in these exhibits?

A. It's a very brief summary of state and local Bar association insurance programs.

Q. When was this prepared?

A. I would assume sometime prior to June of 1978.

Q. What was the purpose of preparing this compilation?

A. I've been trying to think of that while you were asking the other questions.

Q. Let me withdraw that and ask you who prepared it?

A. You're asking me who prepared it?

Q. Yes.

A. I don't recall the individual on my staff that actually—

Q. Okay, it was prepared by a member of your staff?

A. It was prepared by someone in my office, yes, sir.

Q. Do you have an opinion whether the data contained in 711-B and summarized in 2310 is accurate, as of the time prepared?

A. Well, without counting all of this and going through them all, I think I would say that the accounts regarding the number of states involved and the number of associations and alumni associations and so on, are contained here in [887] Exhibit 711-B, yes.

Q. Do you know whether this report is furnished to the insurance committee of the Board or to the full Board?

A. I apologize. I couldn't say who this—where this went to. It very well could have gone to the insurance committee.

Q. Have you been able to recall why it was prepared?

A. No, I—I remember this very well, the documents. But as to where it went and the actual reason of why it was prepared, does not come to me.

I would say that it probably went to the insurance committee because of the type of a report it is, it has a cover letter of explanation that would be a courtesy thing to send to the committee. If this went, for instance, to Mr. Zumbrook, why he would already know about this information and we wouldn't have bothered writing a cover memorandum with it, assuming it went to the insurance company.

MR. MARKHAM: Your Honor, we would offer Exhibits 711-B and 2310 into evidence.

MR. GREGORY: No objection.

THE COURT: They are admitted.

(Defendant's Exhibit Nos. 711-B and 2310 were received into evidence and made a part of the record thereof.)

* * * * *

[898] [Breiner—Cross] BY MR. MARKHAM: Q. I've just handed you Exhibit 582 and ask if you can recognize this as a copy of a letter you sent to Mr. Lyles?

A. Yes.

Q. I call your attention to the first page in the last paragraph, the first three sentences beginning, "We discussed the possibilities of increasing premiums"—

A. Yes, I recall.

Q. Did you conclude at that time that you could not increase premiums above the competitive range for this program being discussed?

A. Well, I think we agreed that it would not be of any value to increase the premiums. I think without reading this entire document, I think that it is mentioned in here that the rate generally accepted for this coverage is 72 cents a thousand to 85 cents a thousand. And if we went over the 85 cents a thousand, we very well couldn't sell it to anybody. And that a small or reasonable increase, say a 20 percent increase would only be 14 cents so if you were given a thousand or 2,000 members at 14 cents, this would not amount to very much premium buying.

So we decided after all of this that really an increase in premium wouldn't be of any big value.

MR. MARKHAM: We offer Exhibit 582 into evidence,

[899] MR. GREGORY: No objection, Your Honor.

THE COURT: Okay. It's admitted.

MR. GREGORY: This was stipulated, Your Honor. We stipulated admissibility.

(The document referred to, previously marked for identification as Defendant's Exhibit No. 582, was received in evidence.

BY MR. MARKHAM:

Q. Mr. Breiner, I just handed you Exhibit 1706. And ask if this is a document that you prepared?

A. Yes, this is the document that I prepared.

Q. Does this—did the discussion at this meeting deal with the problems of the ADD 250 program?

MR. GREGROY: Your Honor, the first paragraph of the document indicates that it's the major medical insurance program.

BY MR. MARKHAM:

Q. Well, referring then to the second half of the first page—well, excuse me—did this deal with the major medical program?

A. This was the—the essence of this document is dealing with the major medical.

Q. What were the problems with that program as of [900] 1980?

A. It wasn't producing sufficient premiums to pay claims or to give the endowment a satisfactory contribution from the membership.

Q. Was that program retained despite these problems? In other words, kept in effect?

A. We still have the program. We have had three premium increases over the last three years, and we are anticipating a fourth increase next spring so we are maintaining the program with premium increases so that we can get sufficient contributions from the members as well as pay for the administration of it.

Q. Now, going down to the bottom of page one, it says—I would guess that there are very few members that acknowledge of the purpose of the programs for NABEs source of contributions other than a source to obtain group insurance at attractive rates although we continually advertise the endowment's purpose in sponsoring the plans, my reaction is that basically the member is interested in his welfare and not necessarily the endowments. On what basis did you reach that opinion of the members' sentiments toward the endowment insurance programs?

A. Well, number one, there hadn't been a dividend of any size for some time, so the member had nothing to deduct on his income tax as a contribution to the endowment, and [901] it was my feeling that as such he was strictly interested in the product that was being offered, and the price of the product. There is no contributions involved, and so anything that might look attractive to him in, let us say, giving back something to his profession in the form of a contribution to this program was nil so—

Q. Did this statement only refer to the major medical program?

A. This is what we are talking about here, major medical program.

Q. I'm referring you now to the second last sentence beginning that I would guess that—does it say "programs" plural there—"I would guess that there are very few members that acknowledge the purpose of the programs"?

A. It is plural—programs.

Q. Okay.

MR. MARKHAM: Your Honor, we move the admission of Exhibit 1706.

MR. GREGORY: No objection, Your Honor.

THE COURT: Okay. It's admitted.

(The document referred to, previously marked for identification as Defendant's Exhibit 1706 was received in evidence.

MR. MARKHAM: 742.

* * * * *

[905] [Breiner—Cross] Q. Did this file—the information contained in it—add to your base of knowledge which you drew upon in evaluating the endowments insurance programs and in making recommendations to the board regarding them?

A. Well, I was certainly privy to the premiums that were offered by those big local buyers that we had brochures on. I don't--I don't recall wherever that any of the benefit levels or any of the provisions of those programs was in direct result—resulted in any direct change to any of our programs.

Q. Did it give you a knowledge of the general marketplace of what was being offered?

A. Oh, certainly, yes.

Q. Approximately what percentage of your staff devoted all or the majority of their time to running the insurance program?

A. Well, none of them ran the insurance program.

Q. Working on the insurance program.

A. I mean I was supposed to do that.

Q. What percentage of your staff devoted all or most of their time to working on the insurance programs?

A. I would say probably 80, 85 percent.

* * * * *

[928] [Breiner—Cross] A. We're still having problems with the United States Government.

Q. In the—what's been marked as Exhibit 759, Mr. Zumbrook states in the committee meeting there was a certain air of pessimism over the current rates for both life and disability plans as being non-competitive. As you know, everytime we have seen a new offering of insurance on a mass basis to professional people, we have reviewed the rate structure for competitiveness. Is that an accurate statement?

MR. GREGORY: Objection. Competency.

THE COURT: Overruled.

THE WITNESS: I don't know when he says "we" if he was meaning he and I, or he and Rollings, Brigg and Hunter. I don't think that everytime a—some kind of an insurance program went out on a mass basis that we did a big statistical study on it.

BY MR. DENNIS:

Q. What about the next two sentences? As a rule the plans being compared are seldom the same as the ABE plans. However, we have never found that the ABE rates

were out of line to any degree which would cause your plans to be non-competitive. Do you agree with that statement?

A. Yes. I think I would agree to that as well as the next one that none of them offer a tax deduction.

[929] Q. I'd like to call your attention to what's been marked as Exhibit 648 and 1798.

THE COURT: I assume Mr. Rubloff is back at the office working on a response in the ABC case.

MR. DENNIS: He told me he was concerned about that, Your Honor.

THE WITNESS: I'm familiar with these two documents.

BY MR. DENNIS:

Q. You are. Would you identify them?

A. Exhibit 1798 is a letter to Mr. Joseph Gordon dated 1977 when he was treasurer of the American Bar Endowment to me with copies to other members of the Endowment Board relating to a group insurance program sponsored by the State—Washington State Bar Association in which Mr. Gordon had sent me previously asking me for my comments on that program.

Q. And Exhibit 648?

A. 648 is a letter from me again to Mr. Gordon dated October 8, 1980 thanking him for the booklet that he submitted to me from the American Business and Professional Trust and in which he asked me on September 26th if I would try to compare their coverage with our coverage.

Q. Did you receive requests from the board to make rate comparisons?

A. Yes, I would receive from time to time brochures on [930] various insurance programs, and they would ask me how does this compare with the endowment program.

Q. And would this be a typical response that you would make?

A. Well, not necessarily. It wouldn't be typical. It explains the differences between our program and this particular program. I mean it probably would be different depending upon the type of program and provisions and so on and so forth that might be involved with the other program. I would certainly reply to any inquiry that a director might make. I mean—

Q. Now, in the exhibit marked 1798, you state, "I am not too concerned with competition by the Washington State Bar as the Endowment is not only well-established but clearly recognized as administering its own insurance programs." Is that statement—

MR. GREGORY: Excuse me. Let the witness find the statement, please.

MR. DENNIS: Excuse me.

THE WITNESS: I've got the statement. I'm trying to find the answer. Yeah, I know the statement. I just wanted to see the brochure. Yeah. This is very good reply to the inquiry of Mr. Gordon, yeah.

* * * * *

[1405] Whereupon—

HERBERT C. BROADFOOT

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MS. CARPENTER:

Q. Mr. Broadfoot, would you state your full name and address for the record?

A. My name is Herbert C. Broadfoot. My address is 364 Lake Forest Lane, Atlanta, Georgia.

MS. CARPENTER: In order to save time, I ask Mr. Broadfoot to state briefly his education, professional experience, his Bar Association memberships and his activities.

THE WITNESS: I was educated as an undergradate Yale University. I graduated in 1966. I graduated from the Vanderbilt University School of Law with a J. D. Degree in 1969.

Following my graduation, I spent four years and four months on active duty in the Judge Advocate General's Court of the United States Navy. That was 1969 to 1973.

In 1973 I moved to Atlanta, where I joined the law firm of Stack & O'Brien for the general practice of law. I was with that firm for three years [1406] until 1976 when I moved to my present firm, Swift, Currie, McGhee & Hiers, a firm of approximately 36 attorneys in Atlanta.

I am a member of the State Bar of Georgia admitted in 1974. I am a member of the Tennessee Bar Association, admitted in 1969.

I am licensed to practice in all of the Courts of the State of Georgia as well as various Federal Courts, including the 5th and 11th Circuit Courts.

I am a member of the State Bar of Georgia which is our Bar Association there. I am a member of the Tennessee Bar Association as a nonresident member. I am a member of the American Bar Association and a member of the Atlanta Bar Association.

My practice is a specialty in bankruptcy and commercial law. In that capacity, as part of my practice, I am a member of the trustee panel for the Northern District of Georgia, practicing in the Bankruptcy Court for the Northern District.

In terms of my professional association memberships, I am a member of several sections of both the American Bar Association and the State Bar of Georgia, and I am presently the Vice-Chairman of the section on bankruptcy law for the State Bar of Georgia.

[1407] BY MS. CARPENTER:

Q. I understand that you are currently enrolled in the ABE life insurance program?

A. Yes.

Q. In the amount of $50,000?

A. That is right.

Q. Did you have that same coverage in 1980 and 1981?

A. I did. I have had that coverage for a number of years.

Q. Directing your attention back to approximately 1980, how much life insurance coverage did you have at that time?

A. In 1980, I had approximately $270,000 in face amount of life insurance coverage.

Q. Can you tell the Court how you came to enroll in the ABE insurance program?

A. I initially enrolled in the ABE insurance program in 1971. At the time I was in the Navy JAG Corps, a member of the ABA, and ABE as well. And I elected to take the coverage that was offered at that time, that was 1971. I was stationed in Great Lake, Illinois. My first child had recently been born and I was interested in obtaining some life insurance coverage at that time.

[1408] Q. Prior to enrolling in the ABE insurance program did you receive a brochure from the ABE?

A. Yes, I did.

Q. And did you read it?

A. Yes, I did.

Q. I am going to show you what has been marked as Exhibits 371 and 372 and ask you to identify them.

(The documents referred to were marked Defendants's Exhibit Nos. 371 & 372 for identification.)

(Document handed to witness by counsel Carpenter)

THE WITNESS: Exhibit 371 is an application form and enrollment form, and on the reverse side is a beneficiary

designation. These are forms that I completed at the time I applied for the insurance.

The Exhibit 372 is application for dependents' insurance, and a dependents' statement of health on the reverse side of that exhibit.

These forms both bear my signature and date of November 22, 1971.

BY MS. CARPENTER:

Q. Did you read these two applications before you signed them?

A. Yes, I did.

[1409] Q. At the time you signed these applications did you know what a dividend was in the sense of an insurance dividend?

A. Yes, I believe so.

Q. How did you know?

A. I had previously obtained some insurance from a private commercial insurance company and knew something about it at that time.

(The document referred to was marked Defendant's Exhibit No. 370 for identification.)

BY MS. CARPENTER:

Q. Next I am going to show you what has been marked as Exibit 370 and ask you if you can identify it.

A. Exhibit 370 is an application requesting group life insurance from New York Life Insurance Company. This is a form that I completed and signed; my wife signed it as well on October 18, 1972.

Q. Was this form used to transfer you into the Plan D of the American Bar Endowment life program?

A. Yes. I note that Plan D is marked on the type of request. My recollection is that the program was revised.

When I look back at Exhibit 371, at that [1410] time it was called the Junior Plan and the Senior Plan, and then they had various units of the Maxi Plan. And I think in

1972 they revised it and labeled the different programs by schedule and then letters. So I think that Exhibit 370 is the transfer of my coverage to the new Schedule D program.

Q. Did you read this application before you signed it?

A. Yes, I did.

Q. Subsequent to enrolling in the ABE insurance program did you receive annual notices from the ABE disclosing what percentage of your premium payment was a contribution to the ABE?

A. Yes, I received an annual notice and it was in the form of a card that was mailed out each year.

Q. I show you what has been previously admitted in evidence as Exhibit 203 and ask you if this is the card?

(Document handed to witness by Counsel Carpenter)

THE WITNESS: This is the card for 1981.

MS. CARPENTER: Your Honor, I hand you Mr. Broadfoot's original, which he is contributing to the cause. You can keep this one. I think I didn't have an extra, at the time, of 1981, so that is why I [1411] brought Mr. Broadfoot's original in.

(The document referred to was marked Defendant's Exhibit No. 369 for identification.)

BY MS. CARPENTER:

Q. I show you what has been marked as Exhibit 369 and ask you if you can identify this document?

A. Exhibit 369 is a copy of six checks, personal checks drawn on my joint checking account at the First National Bank of Atlanta.

These are seminannual premium payments made to the American Bar Endowment in 1969, 1980 and 1981.

Q. Mr. Broadfoot, when you wrote these checks did you write them with the knowledge that a substantial portion of the amount paid would be a contribution to the Endowment for its work in the field of law?

A. Yes, I did.

Q. Mr. Broadfoot, why didn't you take a deduction on your tax return in 1981 for your contribution to the Endowment?

A. I was preparing my tax return at the last minute, as I unfortunately seem to do each year. And at the time that I was preparing that return I was unable to put my hands on the card that I subsequently [1412] located advising me of the amount of contribution I had made. And I also had some difficulty obtaining the checks so that I knew the precise amount involved.

The calculation becomes slightly complicated in that it pertains to an earlier period of time and it is necessary to gather these materials. As I say, unfortunately I had put it off until I ran out of time and I did file my return without claiming that deduction. I had claimed it in previous years.

Q. Have you had the occasion to review your Endowment policy with an insurance agent from another company?

A. Yes, I have.

Q. And did you also review your other coverage at that time?

A. Yes, I have.

Q. And did your insurance agent give you any advice with respect to your Endowment policy?

A. I have discussed all of my insurance coverage as part of a review of my insurance program, and I was advised by the insurance agent I consulted that the American Bar Endowment insurance program was more costly than the same coverage at his company or at other insurance companies. However, he recognized the contribution feature of this insurance coverage. [1413] That really was what we discussed when we reviewed the program.

Q. And why are you a Plaintiff in this action?

A. I was requested by one of my law partners to volunteer as a Plaintiff in this action, and I agreed to do so. I felt that the cause was right and I believed in the program. So I was willing to volunteer my time to this case.

MS. CARPENTER: Your Honor, I offer Exhibits 369, 370, 371, and 372 in evidence.

MR. MARKHAM: No objection, Your Honor.

THE COURT: They are admitted.

(The documents referred to, previously marked Defendant's Exhibit Nos. 369 through 372 for identification, were received into evidence.)

MS. CARPENTER: Your witness, Mr. Markham.

CROSS-EXAMINATION

BY MR. MARKHAM:

Q. Mr. Broadfoot, when did you first purchase Endowment life insurance?

A. Well—

Q. The year?

A. 1971.

Q. When you first enrolled in the Endowment's [1414] life insurance plan did you consider your out-of-pocket expenditure for the program to be outrageously overpriced in terms of the insurance you were receiving?

A. No.

Q. The same question for the period 1978 through 1981, did you consider your out-of-pocket expenditure to be an outrageously overpriced one for the insurance you received from the Endowment?

A. No, I did not.

Q. All things considered, would you consider your out-of-pocket expenditure for the insurance furnished by the Endowment to be a reasonable one?

A. I am not sure that I understand your question. Let me respond in this fashion:

I feel that when I make my payment, when I write this check to the American Bar Endowment it consists of two components. One component is the insurance coverage

aspect of it, and another component is the contribution that I am making to the American Bar Endowment.

So I am not sure whether your question was directed to the insurance component alone or to the total amount—

Q. To the insurance component.

[1415] A. Then would you repeat the question for me, please, as it relates to the insurance component?

Q. Would you consider your out-of-pocket expenditures for the Endowment's life insurance program a reasonable one in terms of the insurance coverage which you received?

A. Yes.

Q. Did you at one time also have coverage through the Georgia State Bar group insurance program?

A. Yes, I did.

Q. Do you recall how much life insurance you had through the Georgia State Bar?

A. I believe that was a $20,000 program.

Q. And do you know which insurance company underwrote that plan?

A. I don't recall the insurance company.

Q. Do you recall that during your deposition on July 11 during your testimony you compared the semiannual premium rates for the Georgia Bar plan and for the American Bar Endowment's plan for $20,000 coverage?

A. Yes, I do recall that.

Q. And do you recall what the results of that comparison were?

A. I think in general we found that the cost of [1416] the Georgia program exceeded the cost of the ABE program for the comparable amount of insurance.

Q. Would it refresh your memory as to the particular figures if I showed you your deposition on that point?

A. I am sure it would. I recall that we specifically went over the numbers involved.

MS. CARPENTER: I think it might be more helpful to show Mr. Broadfoot the figures. In other words, the policy from which he was figuring in his deposition.

MR. MARKHAM: Well, Your Honor, if there is no objection, I have not made sufficient copies of the other policy, and I think it would be quicker just to utilize the deposition. The witness indicated this would refresh his memory.

MS. CARPENTER: I have no objection to Mr. Markham reading into the record the questions and answers Mr. Broadfoot gave in that respect. That might be the quickest method.

MR. MARKHAM: It is somewhat lengthy, Your Honor.

THE COURT: What would you prefer to do, Mr. Markham?

MR. MARKHAM: I would prefer if Mr. [1417] Broadfoot could recall what we were referring to. It is at page 40 through 42.

THE COURT: Why don't you just thumb through, Mr. Broodfoot, to refresh your recollection.

MR. MARKHAM: I think you will find that the Exhibit 6 referred there to the Endowment literature and the Exhibit 4 was to the National Life of Canada policy.

(Deposition transcript handed to witness by Counsel Markham)

MS. CARPENTER: Is there a question pending?

MR. MARKHAM: Yes. As soon as he has finished reviewing the transcript of his deposition.

BY MR. MARKHAM:

Q. Mr. Broadfoot, under the two policies at the age of 30 were you able to refresh your recollection as to what the semiannual premium was?

A. Mr. Markham, it appears that it was $36—the amount of the semiannual premium, age 30, for $20,000 of coverage, that is the State Bar of Georgia program, and

I do recall now that it was National Life of Canada Insurance Company involved.

Q. And the American Bar Endowment's rate for that coverage at that age?

A. Seminannual premium contribution of $25, for [1418] $20,000 of coverage.

Q. And I believe that was for the age bracket 30 through 34; is that correct?

A. That is correct.

Q. Did the State Bar of Georgia plan pay dividends?

A. Not to my recollection.

Q. I think that is all we have on the deposition.

Now, did you terminate your coverage under the Georgia Bar plan due to the fact that you consider it to be too costly?

A. I did terminate my coverage under the State Bar of Georgia program as the result of some conversations and planning with an insurance agent.

Q. Do you still have your American Bar Endowment life insurance?

A. Yes, I do.

Q. And have you ever made any contributions to the Endowment, aside from your participation in the insurance program?

A. No, I don't believe that I have.

MR. MARKHAM: I would like to show you copies of three exhibits which have been marked 8002-A—four exhibits, excuse me. 8002-A through C and 837.

[1419] (The document referred to was marked Defendant's Exhibit Nos. 8002-A through C, and 837 for identification.)

BY MR. MARKHAM:

Q. Starting with 8002-A, can you recognize this as a group of promotional sheets received from the American Bar Endowment by you?

A. This exhibit is a copy of promotional material from the American Bar Endowment and I believe that I did receive this.

Q. Can you put a timeframe on when you might have received this?

A. It refers on page—well, it is the second copied page of the exhibit but it is marked page 3 and it refers to a current nonmedical enrollment period ending May 15, 1978. And also I note on the last page it refers to the American Bar Endowment's 36th year of existence. So I would suspect that this would have been sent out in 1978 prior to May 15. I believe the American Bar Endowment was established in 1942. So that would make it 1978.

Q. Turning to Exhibit 8002-B, the same question, did you receive this promotional packet from the Endowment?

A. Yes, I believe that I did.

[1420] Q. And I take it from the cover you would be willing to estimate that this was received in 1978?

A. Yes, I think we can agree on that.

Q. Turning to Exhibit 8002-C, do you recognize this as promotional material received from the Endowment?

A. Yes, I do recognize this as material sent by the ABE, and it is addressed to my former residence in Atlanta.

Q. And can you place a timeframe on this material?

A. I am trying to find a date on this one.

Q. In other words, you can't recall independently?

A. I can tell you that I lived at the mailing address shown on here until the latter part of 1978. So it would have been prior to that time.

Q. Finally, Exhibit 837. Do you recognize this as the brochure, or set of promotional materials received from the Endowment?

A. That is what it appears to be, but this refers to disability income, and I have not participated in the American Bar Endowment group disability income program. So I am not sure that I would have received this particular item.

MR. MARKHAM: Your Honor, we would moved that Exhibits 8002-A, B, and C, be received in evidence.

MS. CARPENTER: No objection.

THE COURT: They are admitted.

(The documents referred to, previously marked Defendant's Exhibit Nos. 8002-A, B & C for identification, were received into evidence.)

MR. MARKHAM: No further questions, Your Honor.

THE COURT: Anything else?

MS. CARPENTER: Yes, Your Honor, one question.

REDIRECT EXAMINATION

BY MS. CARPENTER:

Q. Mr. Broadfoot, you were quoted in the Government's Memorandum of Contentions of Fact and Law, and I noted Mr. Markham used a phrase you were quoted as using in his cross-examination. The quotation in the Government's brief without citation is "Question: Just as a general statement, as you sit here today having purchased several types of life insurance knowing what you know, would you characterize the ABE rates you are paying as reasonable?"

Your answer: "All things considered, yes."

[1422] My question to you now is when you referred to the things considered, what things were you considering?

A. I considered several factors. The cost of the insurance itself. The contribution feature of the American Bar Endowment program, and what I would call some subjective considerations such as a notion that I was participating through my professional association, the

American Bar association and the Endowment. So I think that when I gave that answer, those were the factors that I was considering.

MS. CARPENTER: No further questions, Your Honor.

MR. MARKHAM: No recross, Your Honor.

THE COURT: Mr. Broadfoot, thank you for your testimony. You are excused.

(Witness excused)

MS. CARPENTER: Mr. Turner, would you take the seat in the witness stand. Or actually, remain standing until Judge Kozinsky administers the oath. Whereupon—

FREDERICK D. TURNER

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATIION

BY MS. CARPENTER:

Q. Mr. Turner, would you state your name and address for the record, please?

A. Frederick D. Turner, I reside at 34 Sunset Lane, Orchard Park, New York.

Q. That is in the Buffalo area?

A. Yes, it is.

Q. Would you kindly give the Court a brief statement of your education, professional experience and Bar Association memberships and activities?

A. Yes. I graduated from Dartmouth College in 1958. After a few years in the Armed Services, I graduated from Cornell Law School in 1963, was admitted to practice in the State of New York in 1963. Also in the District Court of Western New York and in the United States Court of Appeals for the Second Circuit. I am a member of the Erie County Bar Association, the American Bar Association. I was formerly a member of the New York State Bar

Association several years ago. And within the American Bar Association I am a member of the Fidelity Surety Committee of the Negligence and Insurance Section. Also a member of the Construction Forum Committee and the Government Contracts Committee.

I am also a member of the International [1424] Association of Insurance Council and in particular their Fidelity & Surety Committee. And I specialize basically in construction and surety law.

Q. Do you continue to be eligible for membership in the New York State Bar Association?

A. I do not.

Q. You do or don't?

A. I do not at this time.

Q. Are you eligible for membership?

A. I assume I am.

Q. I want to show you what has been marked as Exhibit 376 and ask you if you can identify it.

(The document referrd to was marked Defendant's Exhibit No. 376 for identification.)

MS. CARPENTER: What I show Mr. Turner, Your Honor, is Mr. Turner's original 1972 brochure which he has saved and what I hand Your Honor is our file copy of that brochure.

THE COURT: Thank you.

THE WITNESS: Yes, this was a brochure I received sometime in the fall of 1972 from the American Bar Endowment relating to a group life insurance program.

BY MS. CARPENTER:

[1425] Q. And are you currently enrolled in the ABE group life insurance program?

A. Yes, I am.

Q. Did you receive that brochure prior to enrolling in the program?

A. Yes, I did.

Q. I am going to show you what has been marked as Exhibit 378 and ask you if you can identify it?

(The document referred to was marked Defendant's Exhibit No. 378 for identification.)

THE WITNESS: That is a photocopy of an application requesting group life insurance from New York Life Insurance Company on an American Bar Endowment form. And that is a copy, albeit rather faint, of my signature.

BY MS. CARPENTER:

Q. Did this application accompany Exhibit 376?

A. I believe it did.

Q. Did you read the brochure and the application before signing the application?

A. It is my practice to do so, and to the best of my recollection, I did so.

Q. Directing your attention for a moment to the years approximately 1979-1980, how much life insurance [1426] did you have at that point?

A. Including term, declining term on a house mortgage, I would say betwen 90 and 100,000, approximately, at that time.

Q. And how much ABE insurance did you have and do you have?

A. 20,000.

Q. You have been enrolled continuously since 1972?

A. Yes.

Q. When you enrolled did you know what an insurance dividend was?

A. Yes, I did.

Q. How did you know that?

A. From my other policies that I have had, and I think through general knowledge. At that time I enrolled I had policies with Provident Mutual and Berkshire Life Insurance. And some of those policies I had either the option to reduce premiums or to keep the premiums in and get

some additional life insurance. I think I did one for each one, if I recall.

Q. Those are both mutual insurance companies?

A. Yes.

Q. Subsequent to enrolling in the ABE insurance program did you receive annual notices from the [1427] Endowment disclosing what percentage of your premium payment was a contribution to the Endowment?

A. Yes, I did.

Q. I am going to show you what has been marked as Exhibit 379 and ask you if you can identify it.

(The document referred to was marked Defendant's Exhibit No. 379 for identification.)

THE WITNESS: Exhibit 379 consists of copies of various checks drawn upon my personal account payable to the order of American Bar Endowment, and they represent semiannual premiums toward the life insurance program that is spelled out in the brochure.

BY MS. CARPENTER:

Q. When you made the payments reflected in Exhibit 379 did you do so with the knowledge that a substantial portion of your payment would be a contribution to the Endowment for its work in the field of law?

A. Yes. At this time I had received a number of notices from the American Bar Endowment which had advised me at various times—I think it was on an annual basis, as to the amount of the dividends which were then used as a contribution to American Bar Endowment.

[1428] Q. I am going to show you what has already been admitted in evidence as Exhibit 202 and ask you if that is the notice you received for 1980?

A. I believe I received this probably 1981, but I think it related to 1980. But I did receive this in the mail from the American Bar Endowment.

MS. CARPENTER: Your Honor, this has been admitted in evidence but I am not sure we had an original for you at that time.

(Exhibit handed to His Honor by Ms. Carpenter)

BY MS. CARPENTER:

Q. Mr. Turner, why didn't you take the deduction for the tax year 1980?

A. I believe based upon a portion of the written notice, it had advised that the Internal Revenue Service had taken the position that the contributions that were made to the American Bar Endowment representing my proportion at dividend on my insurance program was not going to be allowed as a tax deduction. I decided that I was not going to take it. At that time I figured I did not need the hassle.

Q. Why did you become a Plaintiff in this action?

A. I suppose I wasn't very well-educated.

[1429] No, the reason I did, I disagreed with the position of the IRS, but I was requested if I would be willing to sort of be a test case as far as the Internal Revenue Service position was concerned. I feel that there are certain obligations that when I disagree with the position of the IRS and when I think it is for the benefit of the Bar Association and fellow lawyers, I felt it was an obligation on my part to be a party to this action.

MS. CARPENTER: Your Honor, at this time we offer Exhibits 376, 378, and 379 in evidence.

MR. MARKHAM: No objection, Your Honor.

THE COURT: They are admitted.

(The documents referred to, previously marked Defendant's Exhibit Nos. 376, 378 & 379 for identification, were received into evidence.)

MS. CARPENTER: Your witness, Mr. Markham.

CROSS-EXAMINATION

BY MR. MARKHAM:

Q. Mr. Turner, when did you first enroll in the Endowment's life insurance program?

A. The application, Exhibit 378, shows the application dated October 1982. It would have been sometime thereafter, shortly thereafter.

[1430] Q. At the time you applied for enrollment in the Endowment's life insurance plan did you feel that it was a good program that fit your needs for insurance?

A. At that time I felt it was a program that I was interested in and I followed through with it.

Q. Were you eligible at any time for enrollment in the New York State Bar life insurance plan?

A. Yes.

Q. Did you ever enroll in that plan?

A. I never did.

Q. Aside from your participation in the Endowment's insurance programs, have you made any other—or have you made any contributions to the Endowment?

A. Well, when you say contribution, I think not necessarily a monetary contribution as such, but I think I have given time to the American Bar Association activities, and it is hard to say where the American Bar Endowment and where the American Bar Association begin and leave off.

Q. No other financial participation?

A. I have not been asked to give anything other than my dividends to their purposes.

MR. MARKHAM: No further questions, Your [1431] Honor.

MS. CARPENTER: No redirect, Your Honor.

THE COURT: Thank you, Mr. Turner, you are excused.

(Witness excused)

MS. CARPENTER: Mr. Sherwood, Your Honor.

Whereupon—

ARTHUR M. SHERWOOD

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MS. CARPENTER:

Q. Mr. Sherwood, would you state your name and address for the record, please?

A. My name is Arthur M. Sherwood. I live at 3770 Windover Drive, Hamburg, New York.

Q. That is in the Buffalo area?

A. That is correct.

Q. Would you briefly give the Court a statement of your education and professional experience, your Bar Association memberships and activities?

A. Yes. I am a graduate of Harvard College and University of Michigan Law School. After law school I served as law clerk to Judge Freeman of the Eastern District of Michigan for two years. I then [1432] worked for the Buffalo law firm of Phillips, Lytle, Hitchcock, Blaine & Hubert, where I have been a partner since 1971. I specialize in trust and estate work. I am a member of the American Bar Endowment, New York Bar Association and Erie County Bar Association. I am a fellow of the American College of Probate Counsel and also a member of the Executive Committee of the New York State Bar Association Trust and Estate Section.

Q. When you—have you ever belonged to the New York State Bar insurance program?

A. Yes, in the 1960s I had some group term life insurance from that program.

Q. Is that a charitable program?

A. I think not.

Q. And are you currently enrolled in the ABE life insurance program?

A. Yes.

Q. And how long have you been in that program?

A. Since April of 1972, I believe.

Q. How much insurance do you have with the ABE insurance program?

A. At the present time?

Q. Yes.

A. I have $20,000 of coverage on my life and [1433] $5,000 of dependent coverage.

Q. Directing your attention back to the period around 1979, 1980, about how much life insurance did you have?

A. All together I had roughly $320,000 of basic life insurance coverage including the American Bar coverage. I also had accidental death coverage of an additional 130,000 and an additional 190,000 or so for death on common carrier. Total of roughly $640,000 if I were to die in that fashion.

Q. Can you tell the Court how you came to enroll in the ABE insurance program?

A. I received some literature in the mail to which I responded.

Q. I show you a document that has been marked as Exhibit 359 and ask you if you can identify it?

(The document referred to was marked Defendant's Exhibit No 359 for identification.)

THE WITNESS: The little brochure you just handed the Court is a document I received from the American Bar Association in 1972.

BY MS. CARPENTER:

Q. Did you read that brochure before you enrolled in the program?

[1434] A. Yes.

Q. I am going to show you what has been marked as Exhibit 356 and ask you if you can identify it?

(The document referred to was marked Defendant's Exhibit No. 356 for identification.)

THE WITNESS: This document is a Xerox copy of my enrollment. The beneficiary designation. And also the check I paid for the initial premium.

BY MS. CARPENTER:

Q. What was the amount of that check?

A. $7.50.

Q. I am going to show you what has been marked as Exhibit 353 and ask you if you can identify that?

(The document referred to was marked Defendant's Exhibit No. 353 for identification.)

THE WITNESS: This was the enrollment form for dependents' insurance which I signed and submitted to the American Bar Endowment in June of 1972.

BY MS. CARPENTER:

Q. Prior to signing and sending in Exhibits 353 and 356 did you read them?

A. Yes.

Q. And did there come a time later, Mr. [1435] Sherwood, when you increased your coverage in the American Bar plan?

A. Yes.

Q. What had been your prior coverage and what is your current coverage?

A. Well, when I purchased the American Bar Endowment insurance for myself in 1972 I think the initial coverage was $8000, I believe, at my age at the time. In 1978 I increased my coverage, and the amount went to $20,000. And in 1979 when I increased the dependent coverage it went from $2500 to $5000.

Q. When you signed these applications did you know what a dividend was on an insurance policy?

A. Yes.

Q. How did you know?

A. Well, through some familiarity with life insurance generally and also in particular from a policy that I held myself from the Northwestern Mutual Insurance Company, which I had purchased before 1972.

Q. Subsequent to enrolling in the ABE insurance program did you receive annual notices from the Endowment that disclosed what percentage of your premium payment was a contribution to the ABE?

A. Yes.

Q. Mr. Sherwood, I am going to ask you to [1436] identify Exhibits 357 and 358.

(The documents referred to were marked Defendant's Exhibit Nos. 357 & 358 for identification.)

THE WITNESS: These are Xerox copies of checks I sent to the American Bar Endowment between December 1978 and December 1981 representing the premium payments for the coverage that I had on myself and my dependents.

BY MS. CARPENTER:

Q. Mr. Sherwood, when you sent the checks to the Endowment that are reflected in Exhibits 357 and 358, did you do so with the knowledge that a substantial portion of that payment would be a contribution to the ABE for its work in the field of law?

A. Yes.

Q. Mr. Sherwood, is the exhibit which I am handing you which has previously been admitted as Exhibit 203 a copy of the notice you received for 1981 with respect to the deductible portion of your premium payment?

A. I think this is the document that I did receive. The original.

Q. Why didn't you take the deduction in 1981?

[1437] A. Well, as this document indicates, the Internal Revenue Service in 1980 had ruled that insured members could not treat as charitable deduction the premium refunds they contributed. This posed to me some question about the deductibility and I elected not to claim it.

Q. Why did you become a Plaintiff in this action?

A. Because I wanted to. I thought that this was a matter that ought to be clarified. I felt that this amount was either deductible or wasn't and it should be subject to determination if there is some controversy and I was willing to be a Plaintiff to help resolve that issue.

MS. CARPENTER: Your Honor, we offer Exhibits 357, 358, 353, 356, and 359 in evidence.

MR. MARKHAM: No objection, Your Honor.

MS. CARPENTER: I can give you that in a better order. 353, 356, 357, 358 and 359.

THE COURT: They are admitted.

(The documents referred to, previously marked Defendant's Exhibit Nos. 353, 356, 357, 358 & 359 for identification, was received into evidence.)

MS. CARPENTER: Your witness, Mr. Markham.

[1438] CROSS-EXAMINATION

BY MR. MARKHAM:

Q. Mr. Sherwood, I believe you testified you were eligible for New York State Bar life insurance program. Did you enroll in that program?

A. I enrolled in it sometime in the 1960s, and I later let my coverage lapse.

Q. Do you know when you let your coverage lapse under that plan?

A. I think it was before 1971 when I became a partner with the firm. The reason being that at that point I acquired additional group term coverage with the firm that I did not enjoy as an associate and I did not feel the need for the state bar coverage at that time.

Q. When you enrolled in the Endowment life insurance program in 1972 did you already have coverage for life insurance under your law firm's group policy?

A. Yes.

Q. Did you increase the amount of your American Bar Endowment life insurance coverage in 1978?

A. Yes.

Q. And did you increase the amount of your dependent coverage under that program in 1979?

[1439] A. Yes.

Q. Have you purchased credit life insurance in the past?

A. Credit life? I don't believe I know what you are referring to.

Q. As part of a loan application did you finance a mortgage either on a house or car or something where there was a life insurance contract in association with that which would pay the loan balance in case you died?

A. I don't believe I have ever done that.

MR. MARKHAM: No further questions, Your Honor.

MS. CARPENTER: No redirect, Your Honor.

THE COURT: Mr. Sherwood, thank you for your testimony. You are excused.

(Witness excused)

Whereupon—

FREDERICK G. BOYNTON

a witness, called for examination, having been first duly sworn, was examination and testified as follows:

DIRECT EXAMINATION

MS. CARPENTER:

Q. State your name and address for the record, please?

[1440] A. Frederick G. Boynton, 4860 North Way Drive, Northeast, Atlanta, Georgia.

Q. Mr. Boynton, would you please state briefly for the Court your education and professional experience, your Bar Association memberships and activities?

A. I received a Bachelor of Arts Degree from the Citadel in 1970. I received a J. D. from Tulane University School of Law in 1973. From 1973 until 1976, I served in the United States Army Judge Advocate General's Corps.

My first assignment was Falls Church, Virginia, as a defense appellate attorney and I represented soldiers who had been convicted in courtmarshal in their appeals to the United States Court of Military Review and the United States Court of Military Appeals.

After that I transferred to Fort McPherson in Atlanta where I was legal assistance officer for 13 months. In October of 1976 I became an associate at the law firm now

known as Gambrell & Russell in Atlanta. I became a partner in that firm in July of 1982.

I am a member of the South Carolina Bar, the State Bar of Georgia, the Federal Bar Association, the [1441] Atlanta Bar Association, the Lawyers' Club of Atlanta and the American Judicature Society; fairly active in the Federal Bar Association. During 1981 and 1982 I served as President of the Atlanta Chapter of the Atlanta Bar Association and I am currently on the Executive Committee of the Federal Bar Association, Atlanta Chapter, and for the last three years on the Board of Directors of the Younger Lawyers Divisions of the Federal Bar Association.

Q. I am going to show you a document that has been marked as Exhibit 380 and ask you if you can identify it?

(The document referred to was marked Defendant's Exhibit No. 380 for identification.)

THE WITNESS: This is a copy of the application I filled out when I applied for a disability insurance policy through the American Bar Association.

BY MS. CARPENTER:

Q. Before you signed the application, did you read it?

A. Yes, I did.

Q. And before you signed the application did you review a brochure with respect to the disability [1442] program that was sent to you by the Endowment?

A. Yes.

Q. Did the brochure disclose the charitable purposes of the plan?

A. It did.

Q. Did you throw away that brochure?

A. I did not save it. Yes.

Q. At the time you signed this application did you know what a dividend or experience credit was?

A. Yes, I had several other insurance policies that paid dividends and I understood that a dividend was based upon the claims experience the company had. So I did understand it.

Q. Subsequent to enrolling in the ABE disability program, did you receive annual notices from the Endowment that disclosed what percentage of your premium payment was a contribution to the ABE.

A. Yes, I received one each year, including one for 1981.

Q. I am going to show you what is already in evidence as Exhibit 202 and ask you if that is the notice that you referred to?

A. This is a notice similar—well, identical to those notices I received. I don't know what year this is for.

[1443] Q. That is a Xerox?

A. Right.

Q. I am going to show you what has been marked as Exhibit 382 and ask you if you can identify that Exhibit?

(The document referred to was marked Defendant's Exhibit No. 382 for identification.)

THE WITNESS: These are copies of five checks of mine; four of them are for semiannual premiums that I paid for my disability insurance through the American Bar Association for the years 1980 and 1981. And the fifth check is a check I paid to Eastern Airlines for membership in its Ionosphere Club for 1981.

BY MS. CARPENTER:

Q. Did you also make similar payments to the Endowment in 1979?

A. Yes, I did.

Q. When you made the 1979 payments and the payments to the Endowment that are reflected in Exhibit 382, did you do so with the knowledge that a substantial portion of the payment would be a contribution to the American Bar Endowment for its work in the field of law?

[1444] A. Yes, I did.

Q. Mr. Boynton, why didn't you take the deduction in 1981?

A. The notice that I received from the American Bar Association for that year said that the Internal Revenue Service had ruled that members could not deduct, as a charitable contribution, that portion of the premium that represented a charitable contribution and, therefore, I did not think that I would do it for that year since I didn't want to litigate at that time with the IRS.

Q. Why did you become a Plaintiff subsequent to that?

A. When I found out that the American Bar Association was challenging the IRS ruling and was offered an opportunity to participate in litigation I did so, because I believed the IRS was wrong.

Q. The second page of Exhibit 382 is a check to the Eastern Airlines Ionosphere Club. Can you tell me what that represented?

A. It represented my membership dues for 1981 to the Ionosphere Club. That club provides lounges in airports for use of the members. The only traveling I did by air in 1981 was for business purposes and I tried to use my time efficiently so what I do is take [1445] work and when I have extra time in airplanes I work in the Eastern Ionosphere Club Lounge.

MS. CARPENTER: Your Honor, because Mr. Boynton has a claim in addition to his American Bar Endowment claim I am going to have him identify his claim for refund as well and explain the two claims. It is Exhibit 183.

(The document referred to was marked Defendant's Exhibit No. 183 for identification.)

THE WITNESS: Exhibit 183 is the Power of Attorney that I signed, an amended income tax return for the tax year 1981, and a narrative explanation of claim for refund that I filed.

MS. CARPENTER: I offer Exhibits 380, 382 and 183 in evidence, Your Honor.

MR. MARKHAM: No obection, Your Honor.

THE COURT: They are admitted.

(The documents referred to, previously marked Defendant's Exhibit Nos. 380, 382 & 183 for identification, were received into evidence.)

MS. CARPENTER: Your witness, Mr. Markham.

CROSS-EXAMINATION

BY MR. MARKHAM:

[1446] Q. Did you apply for your American Bar Association disability insurance in 1978, Mr. Boynton?

A. I did.

Q. Prior to purchasing this insurance had you surveyed or looked at a number of other disability income insurance plans that were available to you?

A. Yes, I did.

Q. Have you received promotional literature from the American Bar Endowment on various occasions?

A. I have.

Q. I would like to show you two exhibits, which are 840-A and 8001-A.

(The documents referred to were marked Defendant's Exhibit Nos. 840-A & 8001-A for identification.)

BY MR. MARKHAM:

Q. I would ask you if you can recognize these as copies of literature that you received from the Endowment?

A. I don't recall one way or the other whether I received a copy of Exhibit 840-A. And I don't specifically recall whether I received a copy of 8001-A, but both documents are similar to the type of promotional material I have received from the American Bar Association over the last five or six years.

[1447] MR. MARKHAM: Your Honor, I believe both of these documents were incuded in Mr. Boynton's responses to interrogatories, and I ask the Plaintiff if they would be willing to stipulate that these were documents received by Mr. Boynton from the Endowment?

MS. CARPENTER: I will accept Mr. Markham's representation that they were attached to the Answers to Interrogatories, and given that they were attached I would be willing to stipulate that he received them.

MR. MARKHAM: We would offer Exhibits 840 and 8001—excuse me, that is 840-A and 8001-A into evidence, Your Honor.

MS. CARPENTER: No objection, based on Mr Markham's representation.

THE COURT: They are received.

(The documents referred to, previously marked Defendant's Exhibit Nos. 840-A & 8001-A for identification, were received into evidence.)

BY MR. MARKHAM:

Q. Did you receive the impression, from reading the promotional literature, Mr. Boynton, that the Endowment sent you regarding their disability insurance plan, that the cost for that insurance coverage was reasonably and competitively priced?

[1448] A. It is difficult for me to answer that. The other policies that I looked at were individual policies offered by Paul Revere Insurance Company and the Equitable.

I do recall also looking at some promotional material from the Federal Bar Association and a group plan but I didn't save that material and I have no present recollection of the terms offered. The other two policies I looked at were more expensive but they had considerably greater benefits than the one offered by the American Bar Association.

Q. Your testimony now is that you cannot form an opinion as to whether, from reading the Endowment's promotional material, you received the impression that the disability insurance plans they were offering were reasonably or competitively priced?

A. I think today they are reasonably and competitively priced, yes.

Q. How about in the periods 1978 through 1981?

A. I don't think I really thought about it at that time. I was satisfied with the policy that I had, it provided the coverage I wanted at a price I was willing to pay and had the added feature of a charitable contribution in the field of law.

Q. I am showing you a copy of your deposition [1449] conducted July 22, 1978, and I ask you to read the questions and answers beginning on page 14 regarding the timeframe 1978 through the present.

A. "Have you received and read the literature sent you by the American Bar Endowment concerning their disability plans, that is promotional literature.

"ANSWER: During what periods of time?

"QUESTION: Beginning in 1978 through the present.

"ANSWER: Yes.

"QUESTION: Did you receive the impression from reading that literature that the American Bar Endowment disability insurance plans were reasonably or competitive priced?

"ANSWER: Yes.

"QUESTION: Forgetting about the literature and just based on your knowledge"—

Q. That is sufficient. Do you recall that testimony?

A. Yes, I do.

Q. Do you have any reason to change your mind about the period 1978 through the present?

A. No.

Q. Aside from your participation in the Endowment's insurance programs, have you made any [1450] financial contributions to the Endowment?

A. Yes, I have.

Q. What were those?

A. Well, I should qualify that. I made several contributions. Whether it was to the American Bar Association or the American Bar Endowment, I don't recall

specifically. I do recall making two contributions, one was to the Second Century Fund, and I don't recall the other one specifically.

But then, of course, every year I have made a contribution through my participation in the disability insurance program.

MR. MARKHAM: No further questions, Your Honor.

MS. CARPENTER: Your Honor, I do just want to clarify a mistake that I made on direct, which was to show Mr. Boynton Exhibit 202 and ask him if that was not the 1981 notice. But 202 is the 1980 notice, so now I want to show him Exhibit 203 and ask him if that is not in fact the 1981 notice. I want the record to be clear.

(The document referred to was marked Defendant's Exhibit No. 203 for identification.)

THE WITNESS: Yes, that is the copy of the [1451] exact notice I received saying 28 percent of my insurance premium was deductible.

MS. CARPENTER: No further questions, Your Honor.

THE COURT: Mr. Boynton, thank you for your testimony. You are excused.

(Witness excused)

THE COURT: We will take a five minute break.

(Witness excused)

(Brief recess)

MS. CARPENTER: Our next witness is Mr. Kenneth J. Burns, and he is President of the American Bar Association.

Whereupon –

KENNETH J. BURNS

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MS. CARPENTER:

Q. Mr. Burns, would you state your full name and address for the record, please.

A. Kenneth J. Burns, Jr. My home address is 115 Fuller Lane, Winnetka, Illinois.

Q. Would you give the Court a short statement with respect to your educational background, your work [1452] experience, and your ABA and ABE service?

A. I graduated from the Northwestern University School of Law in 1951. After a short stint in the Navy I became employed and started work with a law firm in Chicago called Johnston, Thompson, Raymond and Mayer. I became a partner in that firm, but left the firm in 1972 to assume the position of Vice-President and General Counsel of the Anchor Hocking Corporation in Lancaster, Ohio.

In 1979 I became Vice-President General Counsel of International Minerals and Chemical Corporation in Northbrook, Illinois.

Over the course of those years I was active in the Chicago Bar Association, including some service on their board of managers, doing some committee work with the Illinois State Bar Association, but beginning in the late 1950's more active, I think, in the American Bar Association where at first in the Junior Bar Conference where I became Chairman of the Conference in the early 1960s, and then as the delegate from the Conference in the House of Delegates of the ABA, and then in the mid 1960s I was appointed the Assistant Secretary of the ABA in which I served until 1971 when I was elected Secretary of the ABA and became a member of the Board of Governors.

[1453] I was in that position until 1975. And it was in 1975 when I was elected to the Board of Directors of the American Bar Association.

Throughout that period since 1975 I have remained a delegate in the House of Delegates of the ABA and I have been active on some committees of the ABA. Then, of course, my work with the American Bar Association has included in addition to being a member of the board work

on various committees of the Endowment. At one time or another I have been Chairman of the Audit Committee, the Grants Committee, the Insurance Committee. I think I have always been on the Investment Committee.

At the present time I am President of the American Bar Endowment having assumed that office in August of this year. Prior to that time for two years I was Vice-President of the Endowment.

Q. Thank you, Mr. Burns. How large is the American Bar Association board?

A. Ten people.

Q. And who makes up the board, what kind of people are on the board?

A. The members of the board are elected by the membership, each for a term of five years over staggered terms. And they are—well, present [1454] company excepted, I think you would describe them as successful legal practitioners who are well-known in general in the profession.

Q. And do they typically have an American Bar Endowment background?

A. I can think of no exception to that. Many, if not all of them, have been very active in the ABA.

Q. Can you estimate the average amount of time contributed by a board member to the work of the Endowment during a typical year?

A. It would be substantial. I would estimate probably eight to ten days a year are actual meetings, or going to meetings, and then there would be another ten to twenty days of work customarily I would think that would be involved outside of meetings.

Q. And that would depend on what committees you are on?

A. Yes.

Q. Are most of the members of the board in the private practice of law with law firms?

A. Yes, the only exception presently, I think Bert Early, who was a newly elected director, has not been in private practice for a number of years. His background is basically as the Executive Director of the ABA, a position he no longer holds, but that is [1455] the experience factor and reputation factor that I think led to his election.

Q. What is the function of the Board of Directors of the Endowment?

A. The board is charged with managing the affairs of the Endowment.

Q. Do the members of the board actually manage the affairs of the Endowment?

A. Well, on the policy level, yes. And sometimes even in some correspondence. But the day to day manning of the work of the Endowment is done by the employed staff.

Q. You mentioned several committees. What is the function of these committees?

A. In their particular area the Grants Committee, for example, is charged with making whatever studies and investigations there might be necessary to determine worthy beneficiaries of grants from the Endowment. And in holding meetings at which applicants for grants would appear and present their case.

And then finally reviewing those and making recommendations to the board with respect to the grants that should be made by the Endowment.

* * * * *

[1458] Q. During your tenure on the Insurance Committee what was your philosophy with respect to the rates that ought to be charged in the ABE insurance programs?

A. Well, speaking as one member of the Insurance Committee, my philosopy, if you will, was that the purpose of the Endowment's program, of which insurance is a part, was to raise funds, it was a fund raising program. And the funds that were raised necessarily depended upon

the, among other things, there were other sources but primarily, on the rates that were charged for participation in the insurance program.

Those rates had to be, in my view, at a level that would result in a significant annual return of dividend or contribution refund that would provide the Endowment with the wherewithal to carry out its purposes.

Q. During the years in issue, did you have difficulty with any of the programs in terms of [1459] generating substantial dividends?

A. Yes. Yes, there were two, as I recall.

Q. What were those two programs?

A. Well, in the accidental death and dismemberment program, called the ADD-250, I believe, in the first year the experience was very extremely—well, let's say it was bad, in the sense that there was no refund contribution return from Mutual of Omaha. The experience was that bad. And we were very seriously considering whether we made a mistake and maybe we would have to drop that program.

The second area where a problem arose in we were not receiving the refund contribution that we thought we needed to get, wanted to get, was I believe in the major medical program where the inflation in medical cost got ahead of us, and we had to raise the rates rather significantly on two occasions that I remember in an effort to produce the level of overall premium payments that coupled with the experience would result in a refund contribution.

Q. Did the board consider dropping these two programs?

A. Yes. Yes.

Q. Why weren't they dropped?

A. Well, in the case of the ADD-250, Mutual's [1460] reaction to the experience that we had encountered was that this was in the nature of an aberration and was not

likely to recur. And in fact time has proved out their judgment, we kept the program and the program has produced significant refund contributions.

Q. Talking about refund contributions since the years in issue?

A. Since—well, I am not certain which.

Q. Fiscal 1981 is our last year in issue.

A. I think the problem would have occurred in the sense that we had no dividend in one year occurred during the years in issue. Since then there has been a significant refund contribution, so there has been no thought since then of dropping or changing the program.

Now, major medical, all we have done is raise rates although we have considered the fact that if that did not work then we would have to consider dropping the program.

Q. Is that program still under review? Major mdedical, that is.

A. I think it is, yes.

Q. I am going to show you what was admitted into evidence as Exhibit 380, which is an application form for the disability program. I want to point out [1461] some language to you on the application. In the middle where it says "I understand and agree," and it indicates that under subpart D that "any experience credits apportioned to the group policy shall be payable to the American Bar Endowment and are contributions from the participants." Do you see that?

A. I see that.

Q. Has that language always been on the enrollment form?

A. To my knowledge it has substantially to that effect. I don't know whether there has been any change in the actual words used, but in substance, yes.

Q. Can you tell the Court why that language is on the enrollment form?

A. Well, I think it is there because the money that is paid as a result of this enrollment and the others like it, is the money of the members, and they must agree as to what that money is to be used for.

Q. And do you know whether that is the view of the other members of the board?

A. I believe it is. I have not heard any different view.

Q. What happens if an enrollment form comes in with that language struck out, crossed out by the member?

[1462] A. That happened only once that I know of, and in that particular case it was not discovered until after the member had been in the program for a year.

Q. What if it had been discovered when the enrollment form came in?

A. If dicovered when the enrollment form was received by the Endowment it would not have been accepted, it would have been returned to the applicant.

Q. This particular one as you are referring to was not discovered?

A. It was not discovered until the member pointed out why he did not get a refund instead of the notice of the amount that he could claim as a deduction if he wished.

Q. And what did the board—did the board consider this question?

A. Well, at that time I think I was chairman of the Insurance Committee, and I think I had to work that out.

Q. Did the board feel some obligation to this member?

A. Well, the board's policy was quite clear. If you were to be in the program you had to be in the program on the same terms as everyone else who was in the program and here we have an instance of a member [1463] who was in the program for a year on different terms unbeknownst to us and we felt we had to change that.

So we gave him an option, he could continue in the program, but if he did so he would have to continue on the same terms as everyone else.

Q. Did you make an accommodation to that member with respect to that year that he had been in the program without an assignment of dividends?

A. We felt we had to. We felt that he had made a mistake, but also we had made a mistake so we felt we had to accommodate him for that one year.

Q. After the Endowment pays its expenses, what happens to the rest of the money that is returned as dividends and experienced credits?

A. Well, for the most part it will be paid out annually in the form of grants to entities that are qualified to receive grants from the Endowment, such as the Fund for Public Education of the American Bar Association, the American Bar Foundation, National Legal Aid and Defender Association, and many others over the period of time.

From time to time some of the refund contributions are added to the investment fund, or reserve, of the Endowment and held, reinvested, producing income which is then applied for either [1464] expenses or grants, and on occasion then grants have been made from the investment or reserve fund. Best example there would be in the earlier years when monies were taken from the investment funds for the construction of additions or improvements to the Bar Center in Chicago.

Q. Does the board recognize any obligation with respect to the premium contributions that are received from members?

A. Oh, yes.

Q. And what is that obligation?

A. Well, those funds that are received where the members pay their statements must be held and applied solely to be paid to the insurance companies to provide the insurance.

Q. Does the board recognize any obligation with respect to the dividends and experience credits that are received?

A. Oh, yes.

Q. And what is that obligation?

A. Those funds, the refund contributions, must be applied in accordance with the charter provisions governing the Endowment, its purposes.

Q. Have you ever received a complaint from a member that he or she did not understand the [1465] charitable purpose of the program?

A. Oh, I don't think that they didn't understand it. I think the only thing even bordering on that would be a complaint that although they understood it they wish we would change it and simply provide the lowest cost insurance.

Q. During the years in issue did the board receive a proposal from James Group Service, Inc., to administer the insurance programs of the Endowment for about a million dollars a year?

A. Yes.

Q. And was that proposal considered by the board?

A. Yes.

Q. And was it accepted or rejected?

A. It was rejected.

Q. Would you explain to the Court why it was rejected?

A. Well, speaking as one board member at the time, my recollection, and certainly among my reasons was, first of all, if we had accepted it it would have meant we would have had to disband our staff and henceforth we would be really a captive of the outside administrator. And there was really no guarantees that the cost over time would not be increased, so [1466] that it would really be no different than if we had maintained our own staff. So there was really no gaurantee that over time we would have saved money.

And second, and I think probably more important, if we had disbanded our staff and had gone to an outside administrator, even assuming we could have done that at

some savings in expenses, we felt we would be losing one very important characteristic or factor in the Endowment program and that was the board of directors as a group of lawyers with employees responsible to them appealing to the members of the Endowment to support the program. And we thought with our own employees and staff over whom we would have direct supervision we would have a better run, more efficient program, more responsive to the wishes of the participants in the program.

Q. Do you recall what the discrepancy in cost was between the in.. .l James Group proposal and the cost of the Endowment at that time? The costs of running the office?

A. Oh, at that time it might have been 4 to $500,000 a year.

Q. And your concern with respect to cost was that the James Group might eventually charge you as much as your current costs were?

* * * * *

[1478] THE COURT: Good afternoon, please be seated. Are we ready to proceed with the next Plaintiff witness?

MR. GREGORY: Yes, Your Honor, Mr. Ray Zumbrook.

Mr. Zumbrook, if you would go up and stand by the chair, the Judge will administer the oath. Whereupon—

RAY ZUMBROOK

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

MR. GREGORY: Your Honor, I have informed Mr. Zumbrook concerning the procedure we have been following on education and backgrounds and I have asked him to summarize for you his educatic n and military and work experience until the time he became the individual responsible for insurance brokerage services at the ABE in 1962.

THE WITNESS: I graduated from high school in Oak Park, Illinois, in 1944, and proceeded to enroll at the University of Illinois. Upon graduation I put in several semesters before I was drafted at the tail end of world war II. Served in the Army, one [1479] year in the Army of Occupation in Europe, came back and reentered the University of Illinois and finished my undergraduate work in three years and entered law school where I completed a year and a half of law courses and graduated with a BA degree in liberal arts and a substantial number of law credits. I finished off with a semester of insurance courses, and in 1950 took my degree, left the university and started with the insurance brokerage firm of Marsh & McClennen in Chicago. I was employed in their what they called Life Department in the Benefits Section, Employee Benefits Section of the Life Department of Marsh & McClennen in Chicago.

I worked directly for one of the senior account representatives, account executives as they called their sales representatives, and did principally office work and attended meetings with this gentlemen on corporate employee benefit accounts. The largest of these that comes to mind was Beatrice Foods, his principal accounts.

After approximately four and a half years there I left Marsh & McClennen to go with the firm of W. A. Alexander & Company in January, 1955 and I was hired by this firm as the title of Director of Group Sales.

[1480] W. A. Alexander & Company was a general agent representing the Fidelity & Casualty Company of New York for the sale of property and casualty insurance, and housed with W. A. Alexander & Company were approximately 110 commission agents. I was hired by W. A. Alexander to promote the sale of group insurance products with these housed commission agents. Most of them

had some exposure to life insurance and group insurance but technically they were agents selling property and casualty insurance. My job was to train them, to educate them. In doing this, I held seminars with the agents. I did one on one studies with the agents. I took them out to call on their own customers, introducing them and their customers to group insurance products. During the course of my career with W. A. Alexander I was a founder and president of an organization called the Chicago Group Insurance Association, which was the first attempt in Chicago to professionalize people who were involved solely in the sale of group insurance products. Up until that point in time, at least in the Chicago area, the sales representatives of insurance companies were represented by the life insurance agents rather than having their own professional association. We organized this to include the representatives of [1481] insurance companies as well as brokerage representatives as well as consultants.

In the course of my employment with W. A. Alexander, I was called on to teach some business courses at Northwestern University and these were courses in group insurance that were offered to professional people, businessmen, on a night class basis. This went on towards the late 1950's, early 1960's.

At W. A. Alexander in addition to working with the 110 housed commission agents I was also responsible for working with some house accounts where there was no agent as such. The firm was the broker for some larger accounts. One of these was L. Ziegler Corporation, which was the predecessor to Lear Zeigler. Before they moved to Los Angeles I was the brokerage representative on that group account when they first started. I was consultant to one of the brokers in-house on the Bendix account out of South Bend. Again this was in the late 1950's-early 1960s.

In the early fall, approximately August of 1962, I was approached by a Vice-President of Rollins Burdick Hunter Company in Chicago and asked if I would like to join that

company as the manager of their Life Department. The man who called me was the [1482] Vice-President in charge of the Life Department and he was past age 65 and told me he was going to retire in a couple years and I would take his position.

I agreed to that and started work with Rollins Burdick Hunter Company October 15, 1962. At that point in time I assumed managerial duties for a staff that eventually numbered about seven or eight. I assumed duties on major accounts that were office accounts. I assumed some production responsibility for bringing in new business.

DIRECT EXAMINATION

BY MR. GREGORY:

Q. Have you resided in Chicago continuously for, oh, the last 32 years or so?

A. Yes, I have.

Q. What is your current address in Chicago?

A. Business address?

Q. Home address.

A. Home address is 648 Hill Avenue, Green Ellen, Illinois.

Q. And your full name is Ray K. Zumbrook?

A. Correct.

* * * * *

[1497] MR. GREGORY: The first exhibit, Your Honor, is Exhibit 339.

(The document referred to was marked Defendant's Exhibit No. 339 for identification.)

BY MR. GREGORY:

Q. I have handed you Exhibit 339. Can you identify this document?

A. This is the commission agreement between Mutual of Omaha and James Group Service datec July 1979 and provides three quarters of 1 percent commision on the premium on this particular insurance contract.

Q. This is GMT 8888. That has previously been identified as the disability income program. My question to you is whether you had group insurance commission contracts with respect to the other three Mutual of Omaha programs?

A. Yes, we have, and they are all identical to [1498] this one.

Q. When you say they are identical, do I understand your testimony to be that each contract is identical with Exhibit 339 except for the number of the group policy which is inserted in the contract?

A. That is correct.

Q. And has this contract been in effect since July 18, 1979?

A. Yes.

MR. GREGORY: Your Honor, we offer Exhibit 339 into evidence.

MR. DENNIS: No objection.

THE COURT: It is admitted.

(The document referred to, previously marked Defendant's Exhibit No. 339 for identification, was received into evidence.)

BY MR. GREGORY:

Q. I am now going to show you, Mr. Zumbrook, Exhibit 710.

(The document referred to was marked Defendant's Exhibit No. 710 for identification.)

BY MR. GREGORY:

Q. Can you identify this document?

[1499] A. This document includes several commission agreements between Mutual of Omaha and Rollins Burdick Hunter Company. Also between New York Life Insurance Company, and Roilins Burdick Hunter Company.

Q. The date of your letter to Mr. Breiner is October 2, 1973. Can you state whether these particular agreements were in effect until Rollins Burdick Hunter was terminated as the broker of record for the ABE plan?

A. Yes, they were.

Q. Can you tell us whether in 1976 when the accidental death 250, the ADD-250 program was added by Mutual of Omaha in the Endowment you executed an agreement similar to those contained in Exhibit 710?

A. Yes, that is true.

Q. That was between Mutual of Omaha and Rollins Burdick Hunter?

A. In what year?

Q. 1976.

A. Yes.

MR. GREGORY: Your Honor, we offer Exhibit 710 in evidence.

MR. DENNIS: No objection, Your Honor.

THE COURT: It is admitted.

(The document referred to, previously [1500] marked Defendant's Exhibit No. 710 for identification, was received into evidence.)

MR. GREGORY: We have one more broker's contract. This has been labeled protective information, Your Honor. The gentleman in the audience is an associate in our law firm fully familiar with the protective order requirements. Can you identify Exhibit 340?

(The document referred to was marked Defendant's Exhibit No. 340 for identification.)

THE WITNESS: This is the commission agreement between New York Life Insurance Company and James Group Service.

BY MR. GREGORY:

Q. What is the date of that agreement, do you know?

A. I can't read the date.

Q. I believe it says August 27, 1979.

A. I hope that is a 1979. That is what it should read.

Q. Was this agreement in effect between New York Life and James Group Service from the date it was signed until today?

[1501] A. Yes.

MR. GREGORY: Your Honor, we offer Exhibit 340.

MR. DENNIS: May I see that exhibit, please?

(Document handed to Counsel Dennis by Counsel Gregory)

MR. DENNIS: No objection.

THE COURT: It is admitted.

(The document referred to, previously marked Defendant's Exhibit No. 340 for identification, was received into evidence.)

BY MR. GREGORY:

Q. Mr. Zumbrook, did there come a time in 1979 when James Group Service, Inc., proposed to the Endowment and to Mutual of Omaha that James Group Service, Inc., take over the administration of the American Bar Association's major medical insurance program?

A. Yes, we did.

Q. Can you summarize, please, what the circumstances were that led to the proposal by James Group Service to take over the administration of the major medical program?

* * * * *

[1505] Q. Mr. Zumbrook, did there come a time in 1981 when James Group Service made a proposal to the Endowment with regard to the possibility of taking overall administrative functions concerning the insurance program?

A. Yes, we did.

Q. I want to show you a series of documents with regard to that proposal. The first is Exhibit 337, a memorandum dated July 13, 1981, from you, "Subject: ABE administration."

THE COURT: Had you planned to move 729 and 730 into evidence?

MR. GREGORY: Yes, Your Honor. I will be happy to do it now. I would offer Exhibits 729 and 730.

MR. DENNIS: No objection.

THE COURT: They are admitted.

(The documents referred to were marked Defendant's Exhibit Nos. 729 & 730 for identification.)

MR. GREGORY:

Q. Directing your attention to Exhibit 337, Mr. Zumbrook, can you identify the four individuals to whom your memorandum was sent?

A. Yes, Doug Pallay is the President of James [1506] Group Service. Doug Anderson is the Vice-President in charge of sales for James Group Service. Norma Janich is a Senior Vice-President in charge of administration, internal administration, and administration of all of our association business. And Linda Schwartz is Vice-President in charge of our promotion and publication department.

Q. Would you identify the document attached to the cover memorandum on Exhibit 337?

A. This document is the feasibility study we prepared at the request of the American Bar Endowment.

Q. Is this a draft of the study that was ultimately sent?

A. Yes, this is a draft.

MR. GREGORY: Your Honor, we offer 337 in evidence.

MR. DENNIS: No objection.

THE COURT: It is admitted.

(The document referred to, previously marked Defendant's Exhibit No. 337 for identification was received into evidence.)

MR. GREGORY: I am now going to show you Exhibit 329, Mr. Zumbrook.

(The document referred to was marked [1507] Defendant's Exhibit No. 329 for identification.)

BY MR. GREGORY:

Q. Exhibit 329 bears the title "Specifications For Feasibility Study, American Bar Endowment."

My question is whether you can identify the document?

A. I prepared this document for the same four persons previously identified for purposes of making the feasibility study. I formalized the request even though with internal office project I formalized it in the form of specifications, so there would be no question with the staff as to what our purpose was and what we intended to do.

Q. Would you run through this document, "Specifications for Feasibility Study"—if you would excuse me a second.

MR. GREGORY: I would note, Your Honor, that the admissibility of this document is stipulated and I would ask the Court to admit it at this time.

THE COURT: It is admitted.

(The document referred to, previously marked Defendant's Exhibit No. 329 for identification, was received into evidence.)

BY MR. GREGORY:

[1508] Q. Would you start at page 1 and summarize for us what you were attempting to do in putting together these specifications and what type of information is contained in this document?

A. My concern was to distinguish the Endowment program and the Endowment's administration from the typical association plans which these people listed on here were accustomed to seeing and accustomed to administering. So I went to some length to explain that this was not a routine type of administration whereby we would simply go to an insurance company and negotiate a commission and then we would take over the adminstration. This was to be an arrangement between James Group Service and the American Bar Endowment. And, therefore, there were a number of things we had to consider that we otherwise had not been considering for other association purposes.

So I listed specific items. Things that we had to examine. The budget of the Endowment—

Q. Are you now looking at page 2?

A. I have moved on to page 2.

I gave some history as you may have noted, the Endowment is self-administered, programs for 26 years, so on. These were things the staff really did not know and I am aware of because I had been working [1509] with the program so long and that is what the first page is intended to do.

Beyond that, into page 2 we are looking at certain specific items which had to be reviewed by the people responsible in our office for staff, for accounting, for computer activity and for promotion work. And I touch on each of the various aspects of administration on pages 2, 3 and 4.

Q. Let me ask you to say briefly—just give a quick word of explanation as to each of the Roman numeral catagories beginning on page 2, overall budget first, what does that refer to?

A. Well, this is an attempt to emphasize that we are approaching this problem, this report, on a cost accounting basis. I wanted the staff to look at each of the items that we would be servicing, where we would be providing services, where we would be functioning as administrator, examine each of the items in a budget to come up with a cost estimate for the Endowment. I have noted that there are items on the Endowment budget that we would not be responsible for.

Item II, new business promotion, I think the first sentence says the largest single expense item is promotion. This is the biggest part of the budget. [1510] And I asked the lady who runs our promotion department to examine not only what is contained in the specifications here but to examine promotion results from previous years, and I had other copies of booklets and so on that I furnished for her use. That was a specific request requirement on our part to examine the promotion activity.

Page 3, III, billings collections and reports. We would obviously take over all of the accounting procedures. We had to examine our own computer capacity. We examined the arithmetic of the accounting procedures, the procedures performed now by the Endowment, what kind of accounting did they use, what kind of accounting would we use, what kind of reports were they preparing. And included as one of the exhibits is a distribution of premiums by plan, by number of insured people, an attempt to give an itemization of what we would have to do to duplicate the American Bar Endowment processes.

Q. Would you turn to page 4 and summarize the three major catagories on that page?

A. Applications and certificates: It is normal in our office to process new applications by simply sending them to the insurance company responsible for the insurance program. The insurance company in turn [1511] would issue the certificate directly to the individual. I was aware that the Endowment did not follow this procedure and I was concerned that we not propose any changes which would disturb the membership of the Endowment should we take over the program. And so we were considering very seriously what would happen if we in effect processed certain applications that did not have to go to the insurance underwriters and if we also issued the certificates.

Claims: The American Bar Endowment pays no claim, they simply act as conduit between the member and insurance company. At James we do do some claim processing. Here again I wanted to distinguish between what we do for other associations and what we were proposing to do on the Endowment business. And that is I decided that we would do what the Endowment did, send the claims to the insurance company, not attempt to process them in-house.

Item VI, customer service and files: We examined some of the services that the Endowment was providing that we did not provide and some of the services the Endowment

was providing that we didn't think had to be provided. And we looked at their filing systems, looked at their word processing, looked at other activities we would have to become [1512] involved with.

Q. And page 5?

A. Page 5, equipment: This is not really my function. I noted that the American Bar Endowment had the latest word in equipment and I assumed that we should provide nothing less than that.

Personnel: This was a statement of concern that if James Group Service took over the administration there would be a number of key people at the Endowment who literally would be out of work. And I think all I was attempting here was to direct the attention of my staff that if we needed to put on additional people here were some well-qualified people we should consider.

Item IX, administrator liaison: I was in fact stating that the relationships between the Endowment board and James would be the same as between the Endowment board and the current Endowment administration; that we would certainly intend to work with all the committees of the Endowment just as the administrative—well, this is the Endowment staff, had always worked.

And then I noted that we needed a final report by August 8, 1981.

Q. Turn to the exhibits, please. There is [1513] Exhibit A, and then the second page Exhibit C, two Exhibits D in this report, and an Exhibit E and F.

Would you tell us what Exhibit A is first, please?

A. A was furnished to me by the Endowment administrator and lists the specific items that went into the Endowment budget for 1981 and the proposed budget for 1982.

I was not concerned about the dollars involved in each of the items, I was only concerned about the items themselves, to make sure that in our analysis of what we

intended to do and in our report back to the Endowment that we had actually looked at each one of these items, so we have not overlooked anything in our presentation.

Q. What does the cross represent in the left hand margin next to certain numbers?

A. The cross indicates certain items of Endowment budgeted expense that we would not assume, such as travel expense for the directors, legal counsel, investment fees would not be part of the James Group Service administration.

Q. Would you explain the next exhibit, please, Exhibit B, overview of ABE programs?

A. That was my own Exhibit for the benefit of [1514] my staff in looking at this project. I put together these number from information furnished to me by the Endowment staff. The premium on the five different insurance plans for this particular period of time, the number of insureds, the number of claims processed by plan, the number of bills prepared by the Endowment accounting department, and the number of new applications processed by the new business department for each of the programs. This was to give us an overview of what we would be expected to do in our own office.

Q. What is Exhibit C?

A. C is a summary of the promotional activity for the 1981-1982 mailing schedule. This was submitted to me by the person in charge of the Endowment Publication and Promotion Department.

Q. And D?

A. There are two Exhibits D. Both of them relate to publications and both relates to the budgeting for publications. And again this was a further explanation of Exhibit C, and it contained dollars of budget for the various campaigns projected for the year. It also contains some editorializing on why the budget was as it was. We were not concerned with that.

[1515] Q. What is Exhibit E?

A. Exhibit E is an analysis of the billings required in order to collect premiums from the members on the various programs. The billings were prepared by the American Bar Association computer system which was leased by the Endowment for this purpose.

Q. And F?

A. I became aware that the American Bar Endowment computer system was producing a lot of reports. I was concerned whether if James Group Service took over the program whether we would need all of these reports. This was a statement prepared by the head of the American Bar Association computer department for Mr. Breiner, in which he lists all of the various reports submitted. Ultimately we determined that we did not need all of these reports if we were going to take over the system.

Q. Ultimately did you submit a proposal to the Endowment?

A. Yes, we did.

Q. Who asked you, what individual at the Endowment had asked you to perform this function?

A. Judge Walter Craig asked me at the June 1981 board meeting, as I recall.

Q. Was he president of the Endowment at that [1516] time?

A. Yes, he was.

Q. I am going to hand you two documents. The first is Exhibit 1718, and the second is Exhibit 737.

(The documents referred to were marked Defendant's Exhibit Nos. 1718 & 737 for identification.)

BY MR. GREGORY:

Q. I would like to ask you to identify both documents, Mr. Zumbrook?

A. Exhibit 1718 is my transmittal letter to Mr. Breiner enclosing the study requested by Judge Craig, with copies of the proposal also given to the directors and Mr. Sutherland.

MR. GREGORY: Your Honor, Exhibit 737 is stipulated admissible. We would also offer Exhibit 1718, the cover letter to Exhibit 737.

MR. DENNIS: Excuse me, you are saying 737? I think once you said 1737, but you are specifically referring to 737?

MR. GREGORY: If I did, I misspoke. The stipulated Exhibit is 737 entitled "Insurance Administration Feasibility Study" and I also offer the cover letter, Exhibit 1718.

THE COURT: All right.

[1517] MR. GREGORY: Both admitted, Your Honor?

THE COURT: Both admitted.

(The documents referred to, previously marked Defendant's Exhibit Nos. 1718 & 737 for identification, were received into evidence.)

BY MR. GREGORY:

Q. Please turn your attention now to Exhibit 737, Mr. Zumbrook. I would like you to do basically what you did before in connection with your specifications and take us through this exhibit, just summarizing what information you were intending to give the Endowment?

A. I would like to note that this is—we did not consider this a proposal to the Endowment; we considered this a feasibility study, which is the reason for the title. This was to give the Endowment an indication of what a third party administrator would charge if a third party administrator was running the insurance plans in lieu of the Endowment staff.

Q. There is a figure in the document as to—on page 6, the figure of $997,600. Would you explain to me what IV meant, "Proposed Budget for Fiscal 1981-1982"?

[1518] A. This is our estimate of what we would charge the Endowment if we in fact had taken over the administration of the program as a third party administrator. This would be our cost plus our profit.

Q. And how much profit was included in the figure?
A. Approximately 25 percent.
Q. Approximately $250,000?
A. Pre-tax.
Q. Did James Group Service view this as a competitive bid to the Endowment to take over the administration?
A. Not at the time we presented it.
Q. And why not?
A. I did not want to make an issue of a proposal at this time until I understood what the Endowment had in mind. Basically I was concerned that if we had other competition on this program I wanted to have other options to present a proposal at a later time.
Q. Would James Group Service have accepted an engagement as administrator for the $997,600 figure on page 6?
A. Yes, indeed.
Q. Let me take you back to page 1. What type [1519] of information is contained on page 1?
A. This is a reminder to the directors of who James Group Service is, a brief statement of our activity in the association business. And it lists our banking facility, our legal counsel and reminds the directors that we are a wholly-owned subsidiary of Fred S. James, the fifth largest of the United States insurance brokers.
Q. What information is contained on page 2, 3 and 4?
A. Page 2, 3 and 4, starting with the heading "Assumptions and Objectives," was my attempt to convince the directors that if we took the program over there would be no changes in the style of management of the program, and no changes in the results of the management of the program.

That is, we would continue to use the same insurance companies, we would continue to provide the same services, and we hoped to wind up with exactly the same dividend result as the Endowment had enjoyed while they

were the administrator of their own programs. And I went to some length to point this out that there would be no changes. On page 2 under item B, dividend maintenance, "the goal of the new administrator must remain the same, increasing funds [1520] for grants and aid through contributions from members and effective cost control."

Pages 2, 3 and 4, I might note at the bottom of page 3, "Money Management," there I make reference to the fact that the Endowment had been earning funds on short-term investments of premiums and that it was our intention to let the Endowment continue doing this. We would simply arrange for the Endowment to handle those funds on a short-term basis.

Q. Did this proposal contemplate James Group Service continuing to receive a commission for services as a licensed broker?
A. Yes, it did.
Q. And would there have been any change in the commission agreements that you previously identified as pertaining to the years in issue?
A. It was not our intent to change those.
Q. Would there have been any compensation to James Group other than the commissions for being a broker and the compensation for the administrative functions set out in this report?
A. No, that would have been the total.
Q. Would you turn to page 3, please.
A. Yes. I have that.
Q. Directing your attention to point one, the [1521] second sentence. I want to ask what you meant by the phrase that two programs were not designed to produce substantial contributions but will contribute to the overall purposes of the Endowment in combination with the other programs?
A. It was a matter of record, a couple years prior to this report that we had been considering taking over both the major medical and the ADD-250 as commercial ac-

counts operated by James Group Service as our own business. I had been—or a comment had been made by one of the directors that there might have been a conflict of interest between James Group Service doing this and also providing consulting advice to the Insurance Committee.

I specified these two programs to indicate that we did not have any intention to spin these off and run them as a commercial business, that they would be considered in combination with the other programs, and that all five programs would continue to be sponsored by the Endowment on an experience rated basis. That is why I named the two.

The rest of the phraseology is "not designed to produce substantial contributions." I guess if I had edited that a little more carefully and said "not designed to produce regular substantial contributions." [1522] I think we noted that we had some problems with the ADD-250 program at the outset. Those problems have cleared up through more favorable claim experience. The reverse has been true of the major medical. Certainly we expected substantial contributions. I know the record shows that. And I think the word "regularly" is missing.

Q. Did you present this proposal at the August 1981 board meeting? Of the Endowment?

A. Yes, I did.

Q. Was the proposal subsequently accepted?

A. No.

Q. I ask you to identify two other exhibits—

THE COURT: Mr. Gregory, I want to take a short break at some point. Is there going to be significantly more direct?

MR. GREGORY: Well, I spilled my water again, if you would not mind taking it now, Your Honor, I would appreciate it. Ten minutes more on direct.

THE COURT: All right.

(A brief recess was taken.)

THE COURT: Mr. Gregory.

MR. GREGORY: Your Honor, during the recess I handed both to the court reporter and to the witness the last three exhibits I have, Nos. 1720, 338, and [1523] 745.

(The documents referred to were marked Defendant's Exhibit Nos. 1720, 338 & 745 for identification.)

BY MR. GREGORY:

Q. Would you please identify Exhibit 1720, Mr. Zumbrook?

A. 1720 is a letter from American Bar Endowment—pardon me—my letter to the American Bar Endowment Director William Falsgraph in which I am responding to his letter concerning certain questions he raised after he received my feasiblity study.

Q. Does this letter provide additional information concerning the feasibility study?

A. Yes, it is in response to specific things he inquired.

Q. What is Exhibit 338, it is a letter from you to Mr. Breiner dated October 19, 1981?

A. This letter is in response to certain questions asked of me by Mr. Breiner, and this is my response.

Q. Does this also concern a feasibility study?

A. Yes, it concerns the feasibility study.

Q. The reference at the top of the letter, James Administration Report, does that refer to the [1524] feasibility study?

A. Yes, it does.

Q. Finally, would you identify Exhibit 745, another letter from you to Mr. Breiner?

A. Yes, this one simply is headed administration, but it is the same subject matter. This again is in response to a request from Mr. Breiner for more information regarding the feasibility study.

MR. GREGORY: Your Honor, we offer Exhibits 1720, 338 and 745 into evidence.

MR. DENNIS: No objection.

THE COURT: They are all admitted.

(The documents referred to, previously marked Defendant's Exhibit Nos. 1720, 338 & 745 for indentification, was received into evidence.)

BY MR. GREGORY:

Q. Mr. Zumbrook, you have testified you have been involved with group insurance plans other than the Endowment. In your experience have your other group insurance customers sought large dividends on policies?

A. No, to the contrary. I think I should distinguish employer group policy holders who would [1525] definitely not want to receive large dividends. In fact it would be poor money management on their part and on our part if they received large dividends, dividend being simply refund of overpayment on the premium in the first place; it would be negative cash flow for an employer.

As far as association business is concerned, most associations if not all associations I am familiar with are operated as a service for the members and the dividend back of the association simply has to be distributed back to the members which again causes the association a problem.

Q. Why would that cause the association a problem?

A. It indicates they are overcharging the members in the first place and they have to then account for that money and refund it in terms of reducing their rates or giving premium credits on the billing.

Q. Do you view dividends to policy holders and experience credits as compensation to the group policy holder?

A. No, I don't.

MR. GREGORY: I have no further questions on direct, Your Honor.

* * * * *

[1531] Q. When you refer to "we" who do you mean?

A. When you say cost, what are you comparing, cost relative to what?

Q. The premium charge.

A. Well, the cost that the person receives in the mail as promotional material doesn't mean anything until he has compared it with something. If he accepts the substance of the organization and the ease of applying he may not even bother to compare it with something.

Q. I think you listed a number of things in your direct testimony concerning what you provide for the American Bar Endowment, what services you provide for American Bar Association: Design of benefits, rating of plans, analyzing reports of insurance carriers, consulting on claim problems, advocating the association's position with the carrier, advising on federal group insurance rules, consulting on promotional activities. Have I left anything out of tha list?

A. Not that I can recall.

Q. Would you describe that as being a minimum service arrangement? Is that the minimum services that James Group provides as a broker?

[1532] A. Well, I would like to think that that is a lot more services than anybody else would provide as a broker. But for commission purposes, yes.

Q. Can you describe what a maximum service contract would be?

A. That would be the case where James Group Service would also act as the administrator of the account as well as the broker of record.

Q. What types of services would it perform as administrator?

A. As the adminisrato we would be involved in the promotion and production of promotion pieces for the direct mailing. He would obviously pay for the cost of the mailing. We would obtain the list for the mailing. We

would process applications for participation in the program. We would bill the insureds at least twice a year for premium. We would act as conduit for claims. And in fact we do pay a lot of claims in our office; we have claim auditors in our office.

We would do those things that are expected of a full service third party administrator.

Q. And other than the payment of claims, the Endowment does all those services?

A. I believe it does.

* * * * *

[1603] A. The rates are similar.

Q. The ABE rates are competitive?

A. Competitive with what?

Q. With the non-sponsored plan rates?

A. Generally speaking they are, yes.

Q. You mentioned the substance of the organization as being a factor in determining the attractiveness of a program. Do you recall that?

A. The substance of the organization?

Q. Yes.

A. Yes.

Q. Now, if the rates between the non-sponsor plan and the ABE insurance are comparable would an individual in your opinion be more likely to buy the ABE insurance because of the substance of the organization?

A. Depends on the individual. I would guess normally so, unless the individual does not like the American Bar Association.

Q. But based upon your statement one of the elements of the attractiveness of the program is indeed the substance of the organization?

A. Yes.

* * * * *

[1638] A. I think you are dealing with a subject that has to do with the American agency system. This is the way the system works. The broker receives his remuneration from the insurance company. On the other hand, the broker represents his client in the dealings with the carrier. Tradition, is the only explanation I would have for that.

Q. And in this case the group policyholder would determine the range of services performed by the brokerage firm? I think you indicated that you provide minimal services and that you had proposed to provide maximum services?

A. We can either provide a brokerage function for brokerage commission or we can be the administrator of the program and provide all the administrative services.

Q. And the Endowment decides that, what you will provide; is that correct?

A. That is correct.

* * * * *

[1653] MR. GREGORY: Your Honor, Plaintiff calls Dr. Dan McGill.

Whereupon,

DAN McGILL

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

MR. GREGORY: Your Honor, there has been marked as an exhibit in this case Number 336, personal data sheet for Dan M. McGill.

(The document referred to was marked Defendant's Exhibit No. 336 for identification.)

MR. GREGORY: I am going to ask if counsel for the United States has objection to my offer to admit it in evidence at this time?

MR. GREGORY: No objection.

THE COURT: It is admitted.

(The document referred to was admitted into evidence.)

MR. GREGORY: Pursuant to the procedure we followed, I have asked Dr. McGill to summarize his education and professional experience. He made some notes and I would like him to refer to them at this [1654] time and give that summary.

THE WITNESS: I am a graduate of Maryville College, a liberal arts Presbyterian-related school in Tennessee, where I majored in economics. I received my master's degree from Vanderbilt University also with a major in economics. I received my Ph.D. from the University of Pennsylvania majoring in economics with a specialization in risk and insurance. Later I received my CLU, a professional designation awarded by the American College, with reference to proficiency in life insurance.

I have taught at four universities. My first teaching assignment was at the University of Tennessee, where I taught money and banking, corporation finance, and a range of insurance courses. After one year I moved to the University of North Carolina at Chapel Hill, where I held the first endowed professorship of insurance in the country. I was there three years teaching courses in all areas of insurance. I was a Visiting Associate Professor of Insurance at Stanford University in the summer of 1950. I was recalled to military service during the Korean War and upon my release from service I joined the faculty of the Wharton School at the University of Pennsylvania in 1952. I have been at that institution [1655] since that time.

My area of academic specialization at the University of Pennsylvania has been life insurance including group life insurance and pensions. I have been chairman of the Insurance Department since 1965, and have been Executive Director of the S. S. Huebner Foundation for Insurance Education since 1954, serving also as Chairman of the Administrative Board of that organization since 1965.

I am also the founder and Research Director of the Pension Research Council of the Wharton School which has been functioning since 1952. I was president of the American Risk and Insurance Association in 1959, this being the organization of university-based insurance teachers in the United States.

I am the author of eight books, two of which have been awarded the Elizur Wright Prize for being the outstanding book in the field during its year of publication. I am the author of a 1,000 page text on life insurance which for many years was required text for the Society of Actuaries. In that book I devoted two chapters to group life insurance. There was nothing specific in those two chapters about association group life since at the time the second [1656] edition in 1968 this type of insurance had not achieved the prominence that it has obtained today. Until a few years ago I taught group insurance at the University of Pennsylvania either as a part of the basic course in life insurance or as a part of the graduate course entitled Group Insurance and Pensions. For that purpose I have been familiar with all the literature in the group insurance field including group life and group health.

I am a trustee at Northwestern Mutual Life Insurance Company and in that capacity have had an opportunity to observe first hand how rates are made and how dividends are determined and apportioned. Northwestern Mutual does not offer group insurance directly but does offer group insurance for small cases through a fully-owned subsidiary. For six years I was the Director—sorry, I was the Trustee of a New York based company that writes predominantly group insurance and pensions. After having served the maximum term of six years as trustee I became a consultant to the board and continue in that capacity until the present time.

I have also served as consultant to many business and governmental organizations on employee benefit plans. I was consultant to the Board of [1657] Governors of the

Federal Reserve System for 18 years and helped to set up group life and survivor income program with particular responsibility for monitoring the payment of dividends on the case. I have also carried out consultant assignment with the National Education Association involving its association group insurance. Two consulting reports I have prepared have been published as educational materials.

BY MR. GREGORY:

Q. Dr. McGill, what is the focus of study of the American Risk and Insurance Association?

A. That is an organization of professors of insurance in American colleges and universities. It concentrates on the academic and intellectual aspects of insurance.

MR. GREGORY: Your Honor, Plaintiff offers Dr. McGill as an expert in the theory and practice of risk and insurance.

THE COURT: Any objection?

MR. DENNIS: Your Honor, we don't have any objection that he is an expert in the practice of risk and insurance, but as I understand it Dr. McGill is not going to testify concerning the theory of economics.

MR. GREGORY: Dr. McGill is testifying as to [1658] the theory of insurance, Your Honor. Precisely as I stated in my offer. Our offer is on the theory and practice of risk and insurance.

MR. DENNIS: I think we can clarify this on our cross-examination. I have no objection.

THE COURT: Well, a non-objection should be handled expeditiously, so we have time for objections.

Okay, Dr. McGill is so qualified.

BY MR. GREGORY:

Q. Dr. McGill, have I asked you to prepare a list of documents that you have reviewed in connection with your testimony in this case?

A. Did you ask a question?

Q. Yes, did I ask you to prepare that list?

A. Yes, you did ask me to prepare a list.

Q. There is a list. I am going to hand it to counsel for the United States. We had not marked this as an exhibit, Your Honor, it might expedite proceedings if there is no objection if I could seek premission to mark this as an exhibit in this case.

MR. DENNIS: I have no objection.

THE COURT: Fine.

* * * * *

[1669] [Dr. McGill] A. And I think perhaps the most important characteristics, or one of the most important characteristics of group insurance is the fact that under the larger cases the net cost of the insurance is determined by the actual experience of that particular group whereas with the individual insurance a policy sold to an individual is treated as a part of a dividend class, and dividends on that insurance, if it is participating, is determined by the experience on that class rather than the experience obviously with respect to one policyholder.

MR. GREGORY: Do you want to break, Your Honor?

THE COURT: I think so, for the reporter, if no one needs a break, but he is working hard.

REPORTER: Thank you, Your Honor.

THE COURT: Let's make it a sharp ten minutes.

(A brief recess was taken.)

THE COURT: Mr.Gregory.

MR. GREGORY: Thank you, Your Honor.

BY MR. GREGORY:

Q. Dr. McGill, prior to the break you were distinguishing individual and group insurance. My [1670] question at this time is whether individual and group insurance are the same insurance products?

A. No, they are different products.

Q. Let me take you back for a moment to the employer-employee situation and your testimony that the employee would receive dividends after the employer's expenses were paid. Is that the case in a situation where the employer pays all of the insurance premiums?

A. No, in that situation the employer receives and retains all of the dividends

Q. Why does the employer retain the dividends in that situation?

A. Because he paid all the premiums in the first instance.

Q. Are you familiar with the term association group insurance?

A. Yes, I am.

Q. What are the essential elements of association group insurance?

A. I would say that the first element is the fact that the insurance program is set up by the members of the association acting through their elected representatives. I would characterize that as controlled by the members of the association. [1671] They will determine the features of the plan in consultation with the insurance company, of course. And to some extent will have something to say about the premium structure.

It is also an arrangement under which the members pay all. That is considered to be an undesirable characteristic in terms of employer-employee plans, in fact it is prohibited under state law in many states, but there is no other party in this case to pay the premiums; it is a mutual undertaking on the part of the members of the association, so the members pay all.

But in view of the fact that when you have that situation that you would have a tendency if everyone was paying the same premium for the younger people either to refuse to join or to drop out. The premium is graded by attained

age, usually by five-year age brackets, or else the amount of insurance is graded downward as the person gets older.

And in view of the fact that the members pay the entire premium it is customary for the members to receive the dividends that are payable under the contract.

Q. You mentioned in your testimony before that association group was a relative newcomer on the [1672] insurance scene. Could you summarize its history, please?

A. It originated in the 1950's, I would say, and it made a considerable amount of sense since one of the key requirements for a sound insurance operation, which I believe I failed to note earlier, is that the insurance should be incidental to the group.

In other words, you should not form a group just for the purpose of getting insurance, otherwise you would not get a fair cross section of the population.

In this case people have a reason for joining the association. It is a common professional bond or interest, and there also tends to be higher income people, better educated. Actually, you should have lower mortality because of the characteristics of the group. So it is the closest thing I would say in terms of saying the basic requirements of a sound insurance operation, the closest thing to an employer-employee group.

But since it did arise after the last major revision of the model group life insurance law and its standard definition in 1946, you do not find the law today dealing with association group, and attempting [1673] to regulate it in the same way that they have done with respect to employer-employee groups, credit groups, and multi employer groups.

Q. Could you summarize for the Court, Dr. McGill, the features of association group that make it similar to employer-employee and the features that make it dissimilar?

A. Well, it is similar to employer-employee group in that it covers a large number of—tends to cover a large number of persons, and it is administered—there is a master policyholder, called the master group policyholder.

The sponsor of the plan always performs a number of administrative services. The sponsor generally promotes the application for the insurance. I would say that in an association group that the sponsor generally performs more services than it would under an employer-employee group.

In the single employer plan the insurance is almost invariably related to compensation of the individual, generally being a multiple of his annual compensation, like two times salary; whereas in association insurance you don't have a salary to tie it to so there will be plans that will provide different specified amounts of insurance, and the [1674] individual members can apply for those, but if they apply for more than the basic amount, which in the case of the Endowment plan is $20,000, that they would have to execute and submit a health statement.

There may be other differences that I would think of later, but I think those are the principal differences.

Q. In practice who receives the dividend, the policyholder or experience credit in the association group field?

A. Almost invariably the members of the association receive the dividends or at least they are credited against their next year premiums.

Q. Is that result consistent with insurance theory?

A. It is absolutely consistent with insurance theory and with the contribution concept of dividend distribution.

Q. Under insurance theory is there any other group, organization or person who might have a claim against the dividend or experience credit?

A. No, there is no other organization that would have a proper claim in my opinion.

Q. Dr. McGill, if you would focus, continue your focus on association group insurance: What [1675] factors produce a result in an association group plan where there indeed are dividends or experience credits to be paid?

A. The dividends under any group insurance plan are the difference between the gross premiums paid plus any investment earnings that might be credited to various reserves that are accumulated under group plans, less the incurred claims, less the retention of the insurance company, and that is the dividend.

Now, naturally, anything that affects the mortality or morbidity of the group will have an impact on the dividend, and also the efficiency with which the plan is administered and the size of the commission that is paid and the premium tax that might be involved. So the more favorable the mortality and morbidity and the lower the expenses, the greater will be the dividend.

Q. You mentioned the phrase mortality-morbidity experience. How is that derived?

A. Do you mean in the first instance what assumption is made or how does it occur?

Q. What do you mean when you use those terms?

A. Mortality has reference to the death rate, whereas morbidity has reference to the sickness or disability rate in this context. And, obviously, in [1676] setting the initial scale of premiums the insurance company is guided by either mortality or morbidity tables that reflect observed experience of similar groups; but in a large case the actual experience is determined by the characteristics of the individuals in the plan.

Q. Let me direct your attention to the Endowment plan. Whose characteristics determine mortality and morbidity results in that plan?

A. The precise characteristics of the persons who participate in the plan. I understand they are all attorneys and members of the American Bar Endowment, so it would be the particular characteristics of that group that would determine the experience of the plan and indirectly the dividends that would become available.

Q. Would you expect in practice that a professional association might have the same, better, or worse experience in morbidity and mortality than the population as a whole?

A. In my expectations and in theory, this group should have better mortality and moridity experience than the general population because they are a higher-income group, presumably somewhat more intelligent, they have access to better medical care, [1677] take and utilize more medical care and have better nutrition and presumably are just more sober individuals generally than the population.

And in this case, experience has demonstrated that the theory is correct. In fact, the mortality and morbidity experience on association group insurance is better than that of the general population.

Q. What is a group policyholder, Dr. McGill?

A. Group policyholder is a party to the insurance contract with the insurance company and is the organization to which the master group contract is issued.

Q. What role is performed by an association group policyholder in the overall plan of insurance?

A. The policyholder performs an important administrative service, including the promotion of the insurance; and it also acts in a way to protect the interest of the plan participants.

Q. In what way does the group policyholder act to protect the interest of the plan participants?

A. Well, one, there are, of course, a number of provisions in a group insurance contract; there are even a number of so-called standard provisions that are required

by state law that are designed to protect [1678] the interest of the policyholder. One being the conversion privilege, for example, the group policyholder will make sure that those provisions are observed by the insurance company. They, of course, collect the premiums, remit the premiums, maintain the basic records, and certify the entitlement to benefits of people who die or become disabled or have medical expenses that become payable. So the group policyholder would represent the participants in any dealings with the insurance company, and of course would in the absence of an assignment of dividends would make sure that the dividends are made available to the participants in the plan.

Q. In insurance theory and practice does the association group policyholder stands in an agency relationship with the insured members?

A. In my opinion the master group policyholder in the association case is acting in an agency capacity.

Q. In insurance theory and practice does the master group policyholder in an agency case stand in a fiduciary relationship with its members?

A. I feel that that relationship could well be construed as being fiduciary in nature.

Q. In fulfilling its role as group policyholder [1679] as a matter of insurance theory and practice should the association make a profit on the association group insurance at the expense of the insured member?

A. Absolutely not.

Q. Dr. McGill, how does one compute the cost of an association group insurance plan?

A. You could express it two ways. You can say it is a gross premiums less incurred claims less retention, plus allocable expenses, which of course gives you the dividend. So it is really the gross premiums less the dividends plus allocable expenses would be one way.

But the other way to look at it is simply it is incurred claims, the expenses of the insurance company and the expenses of the master group policyholder. Those three elements would constitute the cost of the insurance in the broad sense.

Q. What is your definition of fair market value?

A. I think fair market value is the price at which a good or service would be exchanged between a wiiling seller and a willing buyer, with neither being under compulsion to buy or sell and with each having knowledge of the relevant facts concerning the transaction.

Q. How should an individual go about [1680] determining the fair market value of an insurance product?

A. I think you determine the fair market value of a given insurance product in terms of the net cost to the policyholder. And in individual insurance the net cost is the gross premium less the dividend, if it is a participating policy.

If it is non-particapating, it is the gross premium that has been paid. In association and any group insurance case the net cost is the gross premium less the dividends and that would be true also of an association group case.

Q. Dr. McGill, in your opinion would the net cost of insurance in an association group case change if the members of an association permitted the association to keep dividends or experience credits for charitable purposes?

A. No, sir, that has nothing to do with the net cost. That simply has reference to the disposition of the premium refund.

Q. In valuing an insurance product, Dr. McGill, is it proper to value that product by reference to the characteristics or value of a different product?

A. In my opinion that would be absolutely unjustified to value a product in terms of the costs of [1681] some other product.

Q. May the fair market value of a particular association group insurance plan be tested by reference to the price of some other type of insurance?

A. No, sir. That would be improper.

Q. May the fair market value of a particular association group insurance plan be tested by reference to a different group and the characteristics of the different group?

A. Absolutely not.

Q. May the fair market value of a particular association group insurance plan be tested by reference to individual insurance?

A. No, that would be a different risk classification all together.

Q. May the fair market value of a particular association group insurance plan be tested by reference to the price of mass marketed commercial insurance issued by a credit card company?

A. No, that would be grossly improper.

Q. What about an oil company?

A. Same answer, it would be improper.

Q. What about a bank?

A. No, you would not use the Washington Bank as your frame of reference.

[1682] Q. When looking at the fair market value of a particular association group insurance plan what must that value be tested against?

A. Against the experience of that particular plan and that product.

Q. Would you define mass marketed commercial insurance?

A. That does not have a statutory definition, but it is generally used to refer to insurance offered to persons who hold credit cards with a particular organization like American Express, or hold gasoline credit cards with Shell

Oil or some oil company; or insurance issued on the lives of people who are joined together in some very loose bond of that sort.

Q. Is mass marketed commercial insurance considered to be group insurance?

A. Well, there is a question about that. Some people would regard it to be. In some states it is probably authorized and would be regarded as group insurance. In other states it would not be permitted.

And even where it is permitted there have been many questions raised as to whether it really is a form of individual insurance being marketed under a franchise arrangement.

Q. What is a franchise arrangement?

[1683] A. Well, it would be a type—generally the term franchise insurance is used to apply to a group that falls somewhere inbetween a case that would qualify for true group insurance and individual insurance.

Generally it represents the situation in which individual policies are issued to the people rather than just certificates that you get under a group case. There is generally a larger commission paid to the servicing agent or broker. And there will not be the economies of scale involved in franchise insurance that you have with a true group case.

Q. I would like to direct your attention now to mass marketed commercial insurance on the one hand and to association group insurance on the other, and ask you a question similar to questions you have answered before.

Would you explain to me what features make mass marketed credit card insurance similar to association group and what features make it different?

A. A mass marketed plan, if it is truly issued on a group basis, and with certificates instead of insurance, and with all the economies that you associate with group insurance and with the other safeguards that you associate with group insurance, I [1684] think would be comparable

to association group except for the motivation. The motivation behind mass marketing is profit. Profit to the insurance company and profit to the sponsor of the plan.

Whereas in association group you generally—the insurance is offered as a service to the membership, and made available by representatives of the association with the plan being designed for the particular needs and aspirations of the members, whereas a mass marketing scheme is likely to be taken off the shelf and just contain fairly standard features and is operated for the benefit of the sponsors and the insurance company.

Q. Do commercial mass marketers of insurance make an entrepreneurial profit for their endeavers?

A. They attempt to. They may or may not.

Q. Dr. McGill, as a matter of insurance theory and practice, is it appropriate for an association group policyholder to make an entrepreneurial profit?

A. No, it is not appropriate.

Q. In commercial mass marketing insurance does the insured consumer have any control over the management of the company that mass markets the insurance?

A. No, the members have—the insured members [1685] have no control over either the insurance company or the organization that sponsored the insurance.

Q. And in commercial mass marketing insurance does the insured consumer have any control over the insurance program, terms, conditions, et cetera?

A. No, sir.

Q. In the association group field does an association member have control over the organization that sponsors the insurance?

A. Yes, the members control the association, and through their representatives determine the features of the plan.

Q. Is an offer by a third party administrator to administer a group insurance program an appropriate basis for determining the fair market value of the administrative services performed by the association group policyholder?

A. I think it is not only an appropriate basis, but the best basis, perhaps the only basis.

Q. Dr. McGill, if commissions are agreed upon between an association group policyholder and a third party broker, is that an appropriate way of valuing the services of the broker?

A. I would say it is.

Q. Dr. McGill, if a list is distributed [1686] commercially, and I mean a list of names for mass marketing purposes at a certain price to all who ask for it, is that an appropriate way of valuing the list?

A. It seems to me that is highly appropriate.

Q. Dr. McGill, did you make any rate comparisons between the American Bar Endowment plan and other insurance plans in preparation for your testimony today?

A. I did not make any systematic comparisons.

Q. Why did you not make rate comparisons systematically?

A. I felt that the issue was irrelevant to the present case.

Q. Why is the issue irrelevant in your opinion?

A. Because we know what the net cost of insurance is in this case. It is the gross premiums less the dividends plus the allocable expenses. So what the cost of some other plan would be is completely irrelevant to this case.

Q. Dr. McGill, as a matter of insurance theory and practice, do the insured members of the American Bar Association represented in this case have a right to the dividends and experience credits which they could assign to the Endowment for charitable purposes?

A. Under established practice and concepts and [1687] under the contribution theory of surface distribution the plan members would be entitled to the dividends.

Q. Dr. McGill, have you relied on any documents forwarded to you by my law firm to reach your conclusions in this case as expressed in your testimony?

A. I obviously have relied upon the documents in attempting to get a grasp of the factual situation and the issues involved, but the materials that I have read and the briefs filed and the opinions of the lawyers expressed have had no impact on the conclusions that I reach with respect to the case.

Q. As a matter of insurance theory and practice, Dr. McGill, is the American Bar Association in the business of insurance?

A. No, sir, it is not in the business of insurance.

Q. Does the American Bar Association bear an insurance risk?

A. It does not bear any insurance risk.

Q. Does the phrase "wholesale price" mean anything to you in terms of insurance theory and practice?

A. I have never heard it used.

Q. Does the phrase "retail price" mean anything [1688] to you in terms of insurance theory and practice?

A. Not in this context.

Q. Dr. McGill, have you ever heard a group policyholder of any kind described as a "middle man"?

A. Not by any informed person.

Q. Dr. McGill, have you reviewed the materials we forwarded to you concerning the disclosure by the American Bar Endowment to its members about the charitable nature of the insurance program?

A. Yes, sir, I have reviewed those materials.

Q. In terms of your experiences, did you find those disclosures usual or unusual?

A. I find them to be very unusual because it is very unusual for the dividends to be assigned to the sponsoring organization and therefore that would not be the need for such disclosure as we find in this case.

Q. Dr. McGill, have we compensated you for your expert assistance in this case?

A. Yes, sir, you have.

Q. And did we do so on an hourly rate basis?

A. Yes, sir.

Q. What rate per hour did you ask us to reimburse you at?

A. My standard rate, which is $125 per hour.

[1689] MR. GREGORY: May I have one moment, Your Honor?

THE COURT: Of course.

MR. GREGORY: No further questions on direct, Your Honor.

THE COURT: Thank You.

Mr. Rubloff, I see you are no longer handing questions up, you are actually going to get to the witness.

MR. RUBLOFF: Seems Mr. Dennis is all tuckered out, so he asked me to pinch hit.

THE COURT: After last Friday night, when he went carousing on the town and left us all here to handle the questions?

CROSS-EXAMINATION

BY MR. RUBLOFF:

Q. Dr, McGill, it is a pleasure to make your acquaintance.

Unfortunately, Doctor, I didn't have the opportunity to take your deposition and I am not as conversant with your thesis as I would like to be. But I have looked through the transcript and I listened to your examination this morning.

* * * * *

[1693] A. But generally speaking, you have to have a defined group, a class of person that could be objectively defined and then offer the insurance to that group. So I would make, you know, allowances for the fact that you may have a pretty loosely formed group; I would say that

with the association group you have very clearly defined limits because of the affiliation with the professional organization like the American Bar Endowment.

Q. Well, I am not sure of your answer. Do you know of any particular law or regulation which would have prohibited the American Bar Association from entering into a legal arrangement with an insurance company under which it would sell insurance to both members and nonmembers?

A. First of all, I repeat that quote the American Bar Association does not sell insurance. And I don't believe that it would be permissible. There is a requirement that organizations that assume insurance-type risk must be legally licensed insurance companies. And the question who is doing the insurance business has been around for many many years, [1694] and if an organization is making insurance available on a vocational basis, which I would so interpret your hypothetical situation, it would be forbidden under state law, I think in most all states, from acting in that manner unless it is willing to make itself subject to all the regulations, laws and regulations pertaining to insurance companies.

Q. Well, turning that around then, are you saying that it is legally permissible for an association to sell to professionals in general, that it doesn't have to necessarily sell just to their members?

A. No, I am saying that a professional association must confine its insurance offering, if we may characterize it in that manner, to its membership. That is my understanding.

Q. Of what, the law?

A. It is my understanding of the law and practice.

Q. Well, we won't belabor that subject.

A. Yes.

Q. Let's assume that you are mistaken.

A. Assume that I am mistaken?

Q. Yes.

A. Okay.

[1695] Q. And that indeed the ABE or any organization like it could sell to nonmembers.

A. Yes?

Q. Would that fact change your opinions and conclusions?

A. Well, you would have to define in much more detail what the arrangements are. If you are saying the American Bar Association has recast itself into forming an insurance company, subject to all respects to regulation by the appropriate insurance commissioner, and they go out to offer insurance to the general public, that would depend on the terms of the arrangement. They may be offering non-participating insurance. So you would have to define in much more specificity what the arrangement would be.

Q. I didn't mean to suggest anything such as you have just decribed. I meant to suggest that if all the facts were as they are with the one exception that the Endowment was soliciting and accepting coverage from nonmembers, would that in any way change your conclusions and opinion?

A. Well, it has been so long since I stated my conclusions and opinions, I believe you need to restate which specific conclusion that you have in [1696] mind.

Q. The ultimate conclusion which we started with, and that is that the fair market value of the insurance is always its net cost?

A. Yes?

Q. Now, would that be true even if the insurance was sold to nonmembers?

A. To those nonmembers, yes, the net cost of insurance to them would be the difference between the gross premiums that they paid and the dividends that were generated under the plan. That would be their net cost.

Q. The reason I ask you that is I am trying to get to ascertain the relationship between the fact that this is a group association and your testimony that in your judg-

ment the asociation had some sort of fiduciary obligation to its members. Was that fiduciary obligation a very important element of your analysis?

A. No, I would come to the same conclusion if it were not a fiduciary. I think it is possible it is only an agent rather than fiduciary. In laymen's terms I think it is acting on behalf of the members and you can characterize it as an agency relationship versus fiduciary relationship. But I do not believe [1697] that the Endowment has any legal claim to the premium refunds that come into the monies that constitute a refund of the premiums paid by the members in the absence of a specific agreement to the contrary.

Q. And what I am getting at is is that because of the relationship of the association to its members or is it because of some other fact?

A. No, it is because of the whole arrangement. The fact that this is a group of professionals with a common interest in their profession represented in the development of the plan and in its operation by their own elected representatives, and I think those elected representatives have the obligation, which can be described as a fiduciary obligation, to operate the plan in the interest of the members, and to make the premium refunds available to the members, except for this fact, in this particular case, that the dividends have been previously assigned to the Endowment as a condition of participation in the plan.

Q. Now, in your view would the association have the same obligation to nonmembers, in my hypothetical?

A. I think any group policyholder has an obligation to administer the plan on behalf of all the members of the plan, and to protect the rights and interests of the participants. I am sure that as a [1698] practical matter they wouldn't feel the same affinity, community of interest, with just a general member of the public as they would with one of their own.

Q. Now, given what you have just said, does that mean then that it is not important to your analysis that the insured happen to be members of this association? What is critical to your analysis is that the association is the group policyholder and whoever happens to be the insured it has some obligation to?

A. Well, I think that if there was to be any difference whatsoever, we are saying that you have got the group of professional people who have organized their own mutual undertaking set up through their own representatives.

In a sense there is no assumption of any risk by that group, it is transferred to the insurance company. Once you introduce an extraneous circumstance and someone is not a member of that association, you might argue that the Endowment, even though it is not an insurer, it is bringing people into the picture for whom they would have no other obligation, and the fact that they are now a member of the plan. But I think I go back to the answer that the key factor here is the fact that it is a group of [1699] people who have set up a plan for their own benefit and with the plan being administered for their benefit by their own elected representatives. Administered for their benefit by their own elected representatives.

Q. Dr. McGill, is it relevant to your thesis that the ABE was a charity?

A. No. The net cost of insurance would be precisely as I defined it even though this was a commercial undertaking.

Q. Well, am I correct that you would characterize the reversion back of the dividend from the insured to the association as a gift?

A. It is a charitable contribution, yes.

Q. Or a gift, same thing, right?

A. Yes.

Q. And would you regard the same mechanism as resulting in a gift if the ABE happened to be something other than a charity?

A. It would be a gift but it would not be a charitable gift, wouldn't be deductible.

Q. But a gift?

A. It would be a gift if they assign their dividend to the Endowment, yes.

* * * * *

[1708] A. I want to make it perfectly clear, as has been said by other people, that what we are talking about in this case is the American Bar Endowment acting as an intermediary offering on behalf of New York Life and Mutual of Omaha the types of insurance coverage which the Endowment actively promotes in order to generate charitable income for charitable purposes. I don't think that the Endowment feels that it is in competition with every organization out there offering insurance, because absent the charitable motive it is not very attractive insurance. They are paying a fairly high gross premium generating dividends of roughly 50 percent, and it would not be very attractive in the absence of the charitable impulse of the members. But in the very broad sense that any insurance is in competition with every other similar type of insurance, I would say that this program has some competition but I think that the Endowment has the very specific charitable motive and offers insurance for this purpose, and obviously aggressively promotes it among its members in order to maximize the charitable income that it will have in [1709] order to carry out its very laudable purposes.

Q. Well, just to clarify what you said: I understood from your direct testimony that you were not professing to be an expert on the relative price of the ABE's insurance as compared to competing insurance?

A. I didn't say that I am not an expert, I said I considered it irrelevant and did not investigate it.

Q. Right. Well, but are you nonetheless aware of the market rates?

A. I am generally aware of market rates, yes.

Q. And is that awareness and knowledge the basis for your comment a moment ago that the ABE's gross premiums were relatively high?

A. In comparison to some other cases of other premiums. But I would say that my conclusion was primarily based on the fact that I know from the dividend history that there has been almost 100 percent overcharge, and that would lead me alone to feel that unless we have very imperfect competition, that the rates must be in the higher range that are being charged.

Q. Is that a deduction that you arrive at or is it based upon your knowledge of actual prevailing rates?

[1710] A. No, the prevailing rates has nothing to do with it. I am saying that the rates that have been set for the life insurance portion of this ABE program have rather consistently generated dividends around 45 to 50 percent, so I am saying that any logical person, I mean any person could logically conclude that he or she is being overcharged for the insurance for a very specific purpose, to generate dividends. So I am saying that you couldn't expect an organization that sets its rates or persuades the insurance company to set its rates at a level to generate dividends of that scope, that you would find it hard to believe that any other organization that is charging those gross premiums and hoping to attract its share of the market would be much higher than this. I would think that generally it would be lower.

Q. Well, to use the vernacular, are you saying there is so much water in the gross premium rates of the ABE that they must be higher than other rates that don't have the water in it?

A. I would never use that term.

Q. I did.

A. In insurance I would never use that term. I am saying that margins were built into the gross premium structure with the deliberate intent that [1711] there be

premium refunds which would then go to the Endowment under the arrangement entered into by these members. And I am saying that the margins were such that you would normally expect any organization that was trying to compete on the purely commercial basis, that their rates would be lower and not – at least not much higher than the ABE rates.

Q. But this is surmise on your part, you don't know it as fact?

A. I don't know it, and I don't care. I think it is irrelevant.

Q. Again I am using the word, I won't attribute it to you, but wouldn't you expect to find water in some other group policies?

A. I would expect to find water, if you want to characterize it that way, in some of these commercial mass marketed schemes and I might even say water or something worse in those cases.

Q. So in that respect they would be very similar to the ABE's program?

A. They could be. No, let's not say similar. I would say the rate structure, the gross premiums could be similar to the gross premiums being charged by the ABE, but I have no personal knowledge of that.

Q. Or is it quite possible the ABE rates are [1712] actually lower?

A. It is possible.

Q. And they compete with one another?

A. Only in the sense that I conceded earlier.

Q. Right. Now, am I correct that in your view the principal difference between the so-called mass marketed commercial insurance programs and the ABE program is motivation?

A. That is what I said, and I believe that.

Q. And you were referring to the motivation of the marketer?

A. I was referring to the motivation of the sponsor of the arrangement.

Q. Does the word marketer—

A. It is a loaded word, I do not use the word marketer.

Q. Well, I don't mean to use a loaded word. What is wrong with that word?

A. I would rather use the term master policyholder, master group policyholder or sponsor of the arrangements.

Q. I an sincerely interested. What is wrong with the term marketer, is it a misdesignation?

A. I do not concede that making insurance available from the insurance company to a given class [1713] of people by an intermediary constitutes marketing the insurance. I think that is a question of interpretation.

Q. We won't get into that one, we have a limited amount of time.

A. Yes.

Q. Motivation: The motivation of the mass marketer of commercial insurance—if that is the right term—he wants to make the profit, right?

A. Yes.

Q. And the motivation of ABE?

A. Is to generate premium refunds that would come to the Endowment and support its charitable purposes. With full knowledge now. I think I need to make this clear. A very important aspect of this is that the members of the Endowment sign the agreement knowing that they will assign these dividends. Every year they get a notice, as you well know, that tells them the percentage of their gross payment that constitutes the charitable deduction. There is full disclosure at all times. Whereas with the commercial arrangement there is the same desire to have a margin in the gross premiums but for different motives. And also we believe, if we can believe the discussions we see within the NAIC Task Force, there has been [1714] inadequate

disclosure or perhaps no disclosure to the participating members as to the fact that they are paying perhaps a grossly excessive premium.

Q. Can we agree that the real distinction as to motivation of the group policyholder is not really the question of profits but rather a question of what is going to be done with their profit?

A. No, I would not agree with that.

Q. Would you argue with the notion that the ABE is trying to make a profit so that it can use those profits for charitable purposes?

A. Look, I know that the use to which monies are paid has no bearing in this legal issue involved in this case. I am trying to stick to the very basic. And I don't think that the fact that the ABE is going to use the money for charitable purposes, as laudable as it is from the social standpoint, has anything to do with the legal issues involved in the case.

I do think that the fact that there is full disclosure and that the members know that they are going to forgo the dividends and that they are told each year they have forgone the dividends and exactly how much, that puts this case in a completely different category from the commercial cases.

* * * * *

[1732] Q. Well, do you recognize the possibility that the people in the Endowment who are setting the rate structure have one purpose, and the people who are buying the insurance have another?

A. I regard the officers of the Endowment to be acting on behalf of the plan members who are kept fully informed of what is going on. They are informed in advance, informed annually. There is a great deal of communication, at each annual meeting there is discussion of this, and I feel that if the members as a group do not like

what their representatives are doing, that they can cast them out and certainly withdraw from the program. I do believe in a very real sense that the officers of the Endowment are acting on behalf of the plan members and attempting to carry out their desires and wishes.

Q. Are you saying that you really believe that the attitude about the rate structure as between the people who are establishing the rates and the people who are paying the rates are parallel?

A. Not parallel in that every member of the [1733] plan if given the opportunity would set the rate exactly where it is. But I am saying that the members of the plan as a group realize that they are joining in a program that has a dual purpose. One is to provide valuable insurance coverage to themselves at a rate that will generate a payment to the Endowment as a charitable contribution. And naturally where that rate is set is a matter of judgment. The officers of the Endowment have to judge the strength of the charitable impulses of the membership, but once they have set it and a certain percentage of the members of the Endowment elect to take the insurance, I think they are acting in a fully informed manner, and are certainly accepting that rate structure as long as they participate in the plan.

Q. But from a practical standpoint, isn't it true that an individual member when he is offered this insurance really has two choices: He can either buy the insurance or not buy it?

A. That is right.

Q. But he can't change the rates?

A. He can not change it any particular year. He accepts it at the rates quoted, or he buys elsewhere.

* * * * *

[1747] MS. CARPENTER: Your Honor, our next witness is Ms. Emily Ryerson.

THE COURT: Good afternoon, Ms. Ryerson.

Whereupon—

EMILY RYERSON

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

THE COURT: Sorry that you had to wait around all day. We hoped to get to you earlier. Hopefully you will be done this afternoon. You live in Chicago?

[1748] THE WITNESS: Yes, I do.

THE COURT: You may be on your flight this afternoon.

MS. CARPENTER: We promised to take Ms. Ryerson to dinner in order to make up for her delayed testimony.

THE COURT: Hold out for a nice place. We have some excellent restaurants in Washington and I am sure Sutherland, Asbill & Brennen, their law firm, Plaintiffs, is well aquainted with them. I won't endorse one in particular, but they know.

DIRECT EXAMINATION

BY MS. CARPENTER:

Q. For the record would you state your name and home address?

A. Emily Ryerson, 2006 South Loomis, Chicago, Illinois, 60608.

Q. By whom are you employed?

A. The American Bar Association.

Q. And what is your position with the ABA?

A. List manager?

Q. What does a list manger do?

A. We maintain and rent the American Bar Association membership list.

Q. How did you come to obtain that position and [1749] how long have you been there?

A. I have been there about five and a half years and I was obtained when the list management program started.

Q. You mean when the ABA first started to rent its list?

A. That is correct.
Q. And how long have you been in direct mail?
A. Since 1951.
Q. You have in front of you what has been marked as Exhibit 1212.
(The document referred to was marked Defendant's Exhibit No. 1212 for identification.)
MS. CARPENTER: Your honor, I put a copy on your desk.
BY MS. CARPENTER:
Q. Can you identify this document?
A. Terms and conditions. It is for use of our membership list.
Q. Is this the contract that all the customers for your list must sign?
A. Yes.
Q. Has this been in use since the list rental program started?
[1750] A. Correct.
Q. Who owns the ABA membership list?
A. The ABA.
Q. Do you sell it?
A. We rent it.
MS. CARPENTER: We offer 1212 in evidence.
MR. MARKHAM: No objection, Your Honor.
THE COURT: No objection. It is admitted.
(The documment referred to was received into evidence.)
BY MS. CARPENTER:
Q. Ms. Ryerson, next I am going to show you what has been marked as Exhibit 1209. I think you saw this document in your desposition as well.
(The document referred to was marked Defendant's Exhibit No. 1209 for identification.)
BY MS. CARPENTER:
Q. I ask you if you can identify that document?

A. Yes, it was the original promotion mailing that went out when the membership decided to start renting their list.
Q. And does this document indicate that the ABA membership list is available to insurance companies?
A. Yes.
[1751] Q. And where is that indicated?
A. It is indicated on "Lawyers, their prime prospects for your company's product and services."
Q. And the word life insurance is listed under that heading?
A. Yes, it is.
Q. To your knowledge has the ABA membership list always been available to insurance companies and brokers since the rental program was initiated?
A. As far as I am aware, yes.
Q. And have you always been the list manager?
A. That is correct.
Q. And did the customers come through you?
A. Yes.
Q. And are you the person charged with responsibility of soliciting customers for the ABA list?
A. Correct.
Q. Now, what is the price of the list at this time? When did this brochure go out?
A. In 1978.
Q. 1978?
A. Yes.
Q. And what was the price of the list at that time?
[1752] A. The base price was $35 a thousand.
Q. Suppose someone had wanted to rent the whole list, wanted to send a promotional piece to every ABA member at that price. What would that cost?
A. Approximately $7,000.

Q. Suppose I wanted to split the list? Suppose I were an insurance company that only wanted to contact members who were age 30 to 50. What would be the price for that kind of list?

A. An additional $2 per thousand.

Q. So it would cost you $37 for a thousand names?

A. Correct.

MS. CARPENTER: Your Honor, we offer Exhibit 1209.

MR. MARKHAM: No objection, Your Honor.

THE COURT: It is admitted.

(The document referred to was received into evidence.)

BY MS. CARPENTER:

Q. Next I am going to show you what has been marked as Exhibit 1210, a document that was also used in your deposition, and ask you if you can identify that?

A. It was our promotional mailing piece in 1980.

[1753] Q. Did you say in 1980?

A. Yes.

Q. And what was the price of the list at that time?

A. It was $35 per thousand.

Q. So you had not raised your per thousand?

A. Not at that time.

Q. But did the total list cost more at that time?

A. Yes, because we had additional members.

Q. Now, in July of 1980 what would be the approximate cost of sending a piece to all members of the ABA?

A. Approximately—about $8700.

Q. Was the splitting by date of birth still available?

A. Correct.

Q. So that it would still cost you $37 for a thousand names if you wanted to split an age group off?

A. Correct.

MS. CARPENTER: Your Honor, we offer Exhibit 1210.

MR. MARKHAM: No objection, Your Honor.

(The document referred to was received into evidence.)

[1754] MS. CARPENTER:

Q. Has the ABA raised its prices from $35 a thousand?

A. Yes.

Q. When did that take place?

A. In 1981.

Q. What is the current price?

A. $40 a thousand.

Q. What does it cost today approximately to rent the entire membership list?

A. A little better than $10,000.

Q. Does the American Bar Endowment rent its list from your list department?

A. No.

Q. I am going to show you what has been marked as Exhibit 270 and ask you if you can identify it?

(The document referred to was marked Defendant's Exhibit No. 270 for identification.)

A. It is my fiscal 1979-1980 sales report.

Q. What information is contained in your fiscal year 1979-1980 sales report?

A. Total numbers of orders. Number of labels. The net amount of money received. And commissions paid.

[1755] Q. Just by way of example, would you pick one of the pages and just indicate to us how to read this particular sales report? I think—let's see, on the eighth page, the Connecticut mutual life insurance company appears toward the bottom of the page.

A. They had two orders, total amount of labels 3,104.

Q. Would that mean they rented 3,104 names?

A. Total for the two orders. And it cost them $35.

Q. And would the other information on here be read in the same fashion?

A. Correct.

MS. CARPENTER: Your Honor, we offer Exhibit 270.

MR. MARKHAM: No objection, Your Honor.

THE COURT: It is admitted.

(The document referred to was received into evidence.)

BY MS. CARPENTER:

Q. Finally I am going to show you what has been marked as Exhibit 272 and what has been marked as Exhibit 350 and ask you if you can identify these two documents.

(The documents referred to were marked [1756] Defendant's Exhibits No. 272 and 350 for identification.)

THE WITNESS: These are my job instructions.

BY MS. CARPENTER:

Q. Can you describe what is reflected in Exhibit 272? What is it?

A. 272 is InterAmerica Life Spring of 1981 rented names through the direct media brokerage. They wanted members of certain sectional centers for the year of birth 1930 on under.

Q. So they were looking for older members?

A. That is correct.

Q. And how many names did you supply them and what did you charge them?

A. 4,692 names; and it cost them $215.

Q. And is the promotional piece that was sent to these 4,692 members of the ABA attached to your job instructions?

A. Correct. Not to my job instructions, the final into my file.

Q. And that is the advertisement for prime life-50 plus?

A. That is correct.

Q. And can you identify Exhibit 350?

A. It is also a job instruction, from Western [1757] New England group insurance. They ordered 10,000 names from various dates and they wanted young lawyers under the age of 45 years old.

Q. What did you charge them for 10,000 names?

A. $454.

Q. I want to direct your attention to the years in issue, which are July 1, 1978, to June 30, 1981. Were you willing during those years to make the ABA membership list available to responsible insurance companies?

A. I would see no reason why we shouldn't have.

MS. CARPENTER: Your Honor, we offer Exhibit 272 and Exhibit 350.

MR. MARKHAM: No objection, Your Honor.

THE COURT: They are admitted.

(The docments referred to were received into evidence.)

CROSS-EXAMINATION

BY MR. MARKHAM:

Q. Mrs. Ryerson, can you estimate the number of insurance companies that have rented all or part of the list since you have been employed as the list manager?

A. Not right off, sir, no.

* * * * *

[1787] MR. GREGORY: Next and last is the gentleman patiently waiting here, Your Honor. It is Mr. Lindsay.

Whereupon—

ROBERT LESTER LINDSAY

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. GREGORY:

Q. Mr. Lindsay, would you state your full name and your home address and your present employer?

A. Robert Lester Lindsay, 2 Huguenot Court, Tenafly, New Jersey, 07670. I am currently employed with Tillinghast, Nelson and Warren, consulting actuaries in the New York office.

Q. What is your position at Tillinghast?

A. I am the Vice-President and also a principal of the firm.

Q. As I informed you, Mr. Lindsay, it has been customary for witnesses to refer to notes to describe their educational experience and their professional experience as well as their work experience.

Would you first recite for the Court a summary of your educational experience and your professional experience? [1788] A. Yes, sir.

I received a bachelor of science degree cum laude from the City College of New York in 1955.

I majored in actuary science, which represented the combination of mathematics and economics.

I became a fellow of the Society of Actuaries in 1962, after completing sucessfully the eight exams required for fellowship.

I became a member of the American academy of actuaries in 1965.

I received a designation Chartered Life Underwriter of the American College of Life Underwriters in 1969. This required completion of five examinations.

I became a fellow of the Canadian institute of actuaries in 1972.

In 1969 I attended an executive program conducted by the Columbia Graduate School of Business, which involved the study of economics as well as business matters.

In 1978 and 1979 during the summers I attended the advanced management program of the Harvard Graduate School of Business. This program focuses on the development of executives and gets [1789] involved in areas of business management, planning, financial analysis and related subjects.

Professionally, I have participated in several committees:

I was a member of the Examination Committee of the Society of Actuaries serving on the Part 7 Committee for three years and Part 6 Committee for one year.

Also I prepared numerous short answer and essay type questions for the examinations.

I was consultant to the educational committee when the exams were restructured.

I have been an author of several study notes on financial statements.

I served on the Society of Actuaries Comittee on Ordinary Insurance and Annunities, whose main purpose is to study mortality of insured lives.

I served as secretary and vice-chairman of the Joint Actuary Committee on Financial Reporting Principles. This was a committee that was established by the joint boards of the Society of Actuaries, American Academy of Actuaries, Canadian Institute of Actuaries and Casualty Actuary Society in order to respond to the audit guide prepared by the American Institute of Certified Public Accountants for stock [1790] life insurance companies.

I served on the Committee on Annual Statements and Valuation of Securities of the American Council of Life Insurance.

I served as a member of the Corporate Planning Committee of the Life Office Management Association, and also served as Mutual Life Insurance Company of New York's representative for that association.

With respect to the Federal Employees Group Life Insurance Plan there is a conversion pool that is established for members who convert their insurance, and I was a member and then chairman of the conversion pool managers for that conversion pool.

With respect to the New York State retirement plans, the state controller of New York years ago established an actuarial advisory committee that would meet with the controller at least twice a year to advise him on any changes in the plan or the funding of the plan. I was a member of that advisory committee.

I also served in various capacities for the New York chapter of CLUS, and also have participated in the New York Actuaries Clubs in several capacities.

I have participated in workshops, panels and [1791] so forth for the Society of Actuaries Life Office Management Association and a few other organizations.

I also have taught on several occasions, for example, this Monday I gave a short one-day seminar for the students for Part 7 of the actuary exams.

Q. What is Part 7?

A. That gets into the pricing of the product, and pension plans, as well as federal income tax, and my course, my discussion concentrated on the distribution of surplus to policyholders as well as federal income tax of life companies at the corporate level.

Q. Have you ever testified in Court before today, Mr. Lindsay?

A. No, I have not. Shall I go on with my business background?

Q. Please do. Employment and work experience.

A. Okay, yes.

I was originally employed by Mutual Life Insurance Company of New York in 1954 as actuary trainee during the summer. I rejoined the company in 1955 and then went into military service for two years.

I returned in 1957 and was assigned to the mathematics section of the Actuary Department and worked on individual product development.

[1792] In 1958 I shifted to the actuary programming unit, and was responsible for preparing the programs and completing the work for valuing group products, this is establishing year-end reserve liability for groups.

1959 I became supervisor of a new section called the special calculation section, which was a small unit, about six people. Our function was to perform all actuary work pertaining to individual health insurance. What I mean by actuary work is the preparation of rates, the determination of dividend scales, the calculation of year-end reserves, and also financial analysis and projections throughout the year.

The other portion of the work in this section dealt with group insurance and annunities.

We were responsible for determining the formulas, performing the experience studies and also the case calculations of all dividends on group insurance and group pension cases, and one segement of this was association business.

We also did the group valuation work, that is calculate the year-end reserves for all group business.

In 1962 I became a Fellow of the Society of Actuaries. I shifted responsibilities, and then was [1793] responsible for preparing the actuary portion of the annual statement and projecting the overall company financial results. Part of this job entailed analyzing the gains by source for the various lines of business.

1967 I shifted back into the product area and was responsible for all individual life and annuity product pricing, including the determination of dividend scales.

1969 I was advanced to second Vice-President and resumed responsibility for the annual statement work as well as for the group actuary work.

In 1971 I was appointed Vice-President of Actuary and was the department head of the Actuary Department so essentially I had all the functions performed by the department in my area of responsibility.

The company reorganized in the beginning of 1974 and I became Vice-President for Corporate Finance. The main responsibilities of this department were corporate accounting and corporate actuary work which means the preparation of all financial reports for the corporation, including the annual statement, as well as projecting results for the corporation.

Another division within this department [1794] was income tax, we did all the tax planning and compliance work for the corporation.

1975 I became Vice-President for Group Insurance. As Vice-President I was line of business head and had all functions pertaining to Group Insurance reporting to me with the exception of the marketing of traditional employer-employee benefit plans. As line of business head my responsibility was to formulate the plans for that line of business as well as to be sure that steps were taken to fulfill those plans.

One of my actions was to recognize the potential benefit to the company of the association plan market, in particular professional associations, because I tied in very closely with our individual sales.

One action I took was to establish a special division within the Group Insurance Department that would concentrate its efforts on the development of this particular market.

In fact just looking at the actual results from the time I became group Vice-President in 1975 until the present time, the volume of business on group association cases has probably sextupled.

In late 1976 as a result of another [1795] reorganization of the company which was caused by the untimely death of our President I became Vice-President of Group Pensions. Then shortly thereafter, in the early part of 1977 I was appointed senior Vice-President and chief actuary.

In that capacity I had two roles, one was to be chief financial officer of the company. That is to have an overview of the financial operations of each line of business, and to work with the various line heads in formulating their financial plans, which hopefully would achieve the desired corporate results.

The other hat was as senior officer, where I had four departments reporting to me: Corporate finance, E D P, corporate services and individual actuary.

In June 1982 I left Mutual of New York and joined Tillinghast, Nelson and Warren as an actuary consultant.

Q. During the time you were at Mutual of New York what was the company's position relatively in the association group market?

A. We saw the association group market as a very high potential market for our operation, and endeavored to obtain a much more substantial market position. So we took the steps in the mid 1970s to [1796] aggressively pursue that market.

I would say at that point Mutual of New York has a relatively strong position in the professional association market.

Q. How strong was that position at the time you left Mutual of New York?

A. It was reasonably strong. Because at that point I think our total premium income was on the order of $80 million, and I think we had well over 80 cases in force.

MR. GREGORY: Your Honor, Plaintiff offers Mr. Lindsay as an actuary expert in the theory and practice of group life and health insurance.

MR. MARKHAM: No objection, Your Honor.

THE COURT: Okay, Mr. Lindsay is so qualified.

MR. GREGORY: Thank you, Your Honor.

BY MR. GREGORY:

Q. Mr. Lindsay, Mutual of New York is a mutual insurance company?

A. Yes, sir, it is. In fact it was the first mutual company to offer participating group business. We started in 1842.

Q. What is participating business?

A. The nature of participating business is that [1797] the policy owner is provided insurance at net cost. In effect the profits of the organization flow back to the policyholder.

Q. Are you familiar with the term divisible surplus?

A. Yes, I am.

Q. Would you explain it from your perspective and tell the Court how it is allocated among classes of policyholders?

A. The basic principle of participating business is that each class of business is self-supporting and that insurance is provided at cost. The process that a company goes through in determining divisible surplus is first to look at the overall financial position of the company, because the

solvency of the company and its ability to fulfill the guarantees on the contracts certainly is the first consideration.

So going through the process that we normally go through during each year we would first determine how much surplus do you need as a minimum to meet the risks to which you are exposed.

Secondly, you would look at the projection of the financial results for the company under the current dividend scale over the next five to ten years, [1798] and then finally you would determine the portion of divisible surplus that would be allocable to policyholders. And normally the allocation process follows formulas that have been set by the actuary that reflect the contribution of each class of policyholders to divisible surplus. And so, for example, in the case of the individual lines you would recognize an interest gain, mortality gain, and perhaps either a loss from expense or gain from expense.

On the group side, the Group Insurance, there are several factors to consider. One is the size of the case. The bigger the case the more credit you can give to the actual experience in that case.

On the smaller cases, the credibility of the case is smaller, so you cannot truly reflect the experience of that case in determining the divisible surplus.

But the main objective, though, is to return to the policyholders a significant portion of divisible surplus. When I was at MONY we essentially tried to distribute between 80 and 90 percent of the gain for the year back to the policyholder as dividends.

Q. Are you familiar with the phrase "experience [1799] refund," "experience credit," "retrospective rate refund"?

A. That is the —experience refund is the same as a dividend. It is the process that the stock companies go through in allocating back to group policyholders the

divisible surplus on their products. As a practical matter they have to, in order to be able to compete in the marketplace.

Q. For a large group such as American Bar Association is there any practical difference in the dividend to the policyholder paid by an experienced life insurance company and the experience credit paid by a mutual casualty company?

A. None whatsoever.

Q. Where are the elements involved in the computation of dividends or experience credit?

A. In a group case such as American Bar Endowment you must look at all elements of income as well as disbursements. So certainly the premium generated by the policy is the first ingredient. And if a case has a high premium level, that would naturally lead to a higher dividend and so forth.

The second element would be any investment earnings that the company earns on the funds generated by the case. Usually reserves are established for [1800] fluctuations. You have a normal pattern of cash flow throughout the year on a case, and on a case this size you would reflect the investment earnings of the company on those funds.

On the disbursement side you have claims going out, and of course the claims on a particular case depend on a lot of factors, one being the composition of the policyholders in terms of age or sex, the extent to which new lives are brought into the case versus having old block of business, the more new lives you bring in normally the better the experience would be because you have the advantage of the selection process at issue.

The nature of the benefits certainly would affect the total claims cost.

Another element of disbursement would be the expenses of the case. This involves the commission that you would pay to the broker in obtaining the business, fees paid to

outside administrators that handle the processing of the business as well as claims, any home office costs that would be incurred on this particular plan, such as underwriting, preparation of experience analyses, and related items.

Another term would be any income tax that the company incurs with respect to that case.

[1801] Q. Why would the company incur income tax with respect to the case? Is this federal income tax?

A. Yes, federal—well, we have two taxes; one is premium tax which you certainly would reflect, and the second is income tax.

For example, under the current tax law, which is called TEFRA, most of the mutual companies would be taxed on gain from operations, but according to the tax law they would not receive full deduction for any dividends paid back to policyholders, they would receive a credit equal to 77 and a half percent of those dividends.

So the net effect is that if you wanted to return as a company the full gain as dividend, you can't because you incur a tax on that. So effectively under the current tax law mutuals would wind up paying, say, 84 percent of the gain as dividends and 16 percent would go out as income tax.

Q. Are there any other elements of expense?

A. Well, certainly claim expense, but that would be either at the company level or at the broker level.

Q. You testified that part of your responsibilities at various times at MONY was the preparation of the NAIC annual statement. Would you [1802] explain briefly what that is for a life insurance company?

A. Yes. Each life insurance company must file with its home state as well as all the states in which it is licensed to do business a statement according to the form required by the National Association of Insurance Commissioners. Now, there may be some variations by state.

This statement shows a tabulation of assets as well as the various displays which lead to the gain from operations and the determination of total surplus of the company.

This annual statement also shows gains by the various major lines of business such as individual life insurance, Group Insurance, and so forth.

Q. Does the annual statement contain a page reflecting income to the insurance company and expenses of operations?

A. Yes, it does.

Q. Mr. Lindsay, under NAIC accounting priniciples are dividends to policyholders or experience credits ever reflected as an expense of insurance operations of the company?

A. No, they are not.

Q. And why not?

[1803] A. Because they are divisible surplus of the company. In other words, they are determined according to formulas that the company has developed based upon the experience of the company.

Q. Let me direct your attention to Group Insurance. How do you as an actuary go about evaluating a group insurance policy, determining, say, the fair market value of the group insurance policy?

A. It is fairly standard that the fair market value of Group Insurance would be the premiums paid for the coverage minus any dividends recovered.

Now, in the case of ABE, in which expenses are incurred outside of either the insurance company or through a broker administrator, you should add in the cost incurred in handling the insurance program.

On a normal case, the broker would be performing these services and those services would be one of the expense items that would be reflected in the dividend formula itself.

Q. So the costs of administering the case, as you described it in a normal case would be included as an expense factor in the dividend or experience credit formula?

A. Yes, sir.

Q. Mr. Lindsay, in a case such as the American [1804] Bar Endowment where the individual has assigned dividends and experience credits to the Endowment for charitable purposes, how would you value the ABE group insurance policy?

A. I think it would be the same. In other words, the cost, or the value of insurance is the premium minus dividend plus the cost of operating the insurance program.

Q. Does it make any difference in your analysis if the individual does not year by year actually receive the dividend or have his premium lowered?

A. No, it does not.

Q. Based upon your experience as an actuary in a mutual insurance company, your education and background, Mr. Lindsay, to whom are dividends or experience credits paid in association Group Insurance cases?

A. They are returned to the participants in the case as refunds of premium.

Q. Are they ever utilized to lower premium costs or increase benefits?

A. Yes, they are.

Q. And how many association groups did Mutual of New York have at the time you left?

A. About 80.

[1805] Q. Was there a single group of Mutual of New York that did not return the premiums to the members?

A. No, they were all returned.

Q. In your opinion, Mr. Lindsay, is the actual practices of groups referred to at Mutual of New York consistent with actuary theory with respect to dividends and experience credits?

A. Yes, it is.

Q. Would you explain your answer?

A. The theory is that the policyholder—or the person who is paying for the insurance should get that insurance at cost. And so the dividends should be returned to that particular policyholder.

Q. To your knowledge, Mr. Lindsay, is there any insurance law that requires this result?

A. New York, I believe, under Section 204 for group life insurance—it may be Section 221 for group health—requires on association plans that all dividends, net of any expenses incurred through operating the insurance program, be returned to the policyholders.

Q. Do you know whether the New York law has extraterritorial effect, or to put it another way are you aware of any other states that require this result in their insurance laws?

[1806] A. There probably are some, but I am not familiar with the laws of the other states.

Q. Are you a lawyer?

A. No, I am not.

Q. As an actuary, did you have responsibilities for being familiar with insurance laws as you understood them?

A. I certainly tried to keep aware of developments in law, particularly in New York law.

Q. Have you ever made any investigation, Mr. Lindsay, unrelated to the insurance law, as to whether principles of common law, that is non-statutory law, would require the return of dividends or experience credits to the members of an association absent an agreement on the part of the members that the dividends are or experience credits be utilized in some other way?

A. I have not studied the law, but it is common practice in professional association business, and I think it is a very accepted practice.

Q. In your experiences at Mutual of New York, did you have occasion to become acquainted with third-party administrators?

A. Yes, I did.

Q. And third-party administrators that [1807] specialize in the professional association group market?

A. Yes, I did.

Q. Can you identify some administrators who come to mind who are active in this market?

A. Ter Bush & Powell handled a few of our cases. John Pearl. MICA, which I think stands for Mass Insurance Consultants and Administrators. Smith-Sternan.

I am trying to remember the full name, but we had an individual by the name of Shepherd that we had done work with, but there is a three-part name to the firm and I can't recall the other parts. That was some of them.

Q. Did Mutual of New York do work with James Group Service?

A. Not in the association area. We did have some cases with—I think Fred S. James as a broker on some employer-employee plans, but not on association plans.

Q. Based on your experiences, Mr. Lindsay, can you tell the Court what functions were required to conduct the third-party administration business?

A. The third-party administrator would normally process applications, do some preliminary underwriting, [1808] prepare bills and follow up on bills, do the premium billing and accounting, deal with correspondence from members, process reinstatements of coverage, if the person had lapsed his policy; quite often the administrators would do claims work, particularly on the health side although the life company usually would pick up the claims work on accidental death and dismemberment claims because of magnitude and the cause of death.

The administrator would also be responsible for giving an accounting to the insurance company of the income received in the form of premium payments and the claims

work as well as the statistical information that the insurance company needs in order to establish claim reserves on the case. This is particularly important with respect to health insurance coverage.

The administrators also would be involved in the distribution of the dividends to the participants in the case after the insurance company has determined the amount of dividend to be disbursed.

Q. Would third-party administrators—strike that.

How were third-party administrators compensated by Mutual of New York?

[1809] A. The compensation pattern varied by the nature of the case, the size of the case, the type of the association, the extent to which the administrator had more influence with respect to the association, but by and large the compensation was as a percentage of premium.

For example, on the very small cases—I shouldn't say very small, but say cases under $500,000 of annual premium you might have a pattern of service fees on the order of seven to 10 percent; the premium depending on the coverage provided.

In addition, if the broker—if the administrator is also performing the brokerage function he would receive commissions, both in the first year as well as renewal years. And the first-year commission might be on the order of, oh, 10 percent, which would mean that the first-year compensation would be when you add the commission plus administrative fees, perhaps 18 percent or so.

Then the renewal years, the compensation would be somewhat less.

Now, in the bigger cases, again depending on the nature of the case, but quite often the pattern would be a declining percentage of premium, administrative fee as well as commission. For example, [1810] one schedule I am aware of, we paid 10 percent of the first $500,000 of premium; I think seven and a half percent of the next 500,000, and so

on down to 5 percent of any premium in excess of $5 million. So, for example, in a case that had $10 million of premium the total allowance for administrative services would be on the order of five to six percent.

Then in addition of course we paid commission, and that too was graded by size.

Q. Could you state for a larger case, let's say $10 million or above, what your experience was at Mutual of New York in terms of total compensation for both administrative services and brokerage functions?

A. Again, it varied by size of case and how new the case was. But for an established case, those two together I think represented between eight and a half and twelve percent of premium.

Q. Do those figures include the cost of processing and paying claims?

A. Yes, they do.

Q. By how much would they be reduced if the claim function were not included?

A. Again, it depends on the size of the case. For a very large case, processing of life claims, cost between one and two percent of premium. On the health [1811] insurance cases, health insurance coverage like major medical the cost would be from three to five percent of premium. So in a large case you might have a claim cost of two to three percent of premium, if you had a reasonable mix between say life and health insurance coverage.

Q. At my request did you review the proposal of James Group Service to take over the administrative functions of the American Bar Association case?

A. Yes, sir.

Q. Did you examine the proposed dollar figures of James Group Service?

A. Yes, I did.

Q. My question is whether based upon—excuse me. Based upon your experiences at Mutual of New York are you able to state whether the total dollar proposal by

James Group Service was in the range of proposals, dollar proposals that you would have expected for a case the size of the Endowment, considering the type of insurance offered by the Endowment and other factors displayed in that report?

A. That certainly was in the ball park, yes. It was reasonable. In fact you sort of wonder if the Endowment put the case out to bid whether it could not [1812] get a better offer than the James offer, because a component of the James offer was a profit of, I don't recall the exact amount, but between 20 and 25 percent, and I think with a case that would be as attractive as the American Bar Association the Endowment probably could get other administrators to take it at a smaller profit, given it's a prestigous case.

Q. Are you familiar with situations where larger groups have asked for competitive bids from third-party administrators?

A. Yes, in fact that is one reason why you have a change in third-party administrators from time to time on given association cases. I think there certainly is pressure to reduce the costs.

Q. At our request, did you look at the rates charged by the insurance companies on the American Bar Association programs in an effort to determine whether you or your firm could state whether the rates were reasonable or competitive in the marketplace?

A. I did some preliminary work with respect to the life coverage, where it is a little easier to compare rates for life coverage than it is for the other coverage.

I also compared rates to some extent on the AD&D coverage.

* * * * *

[1839] Q. I would like you to define it.

A. I would say this, that if the American Bar Endowment rates were lower, I would imagine they would get much more participation in the plan. So from that point of view they were less competitive than they could have been in order to attract more business.

Q. Well, as an expert in the marketing or design of Group Insurance plans, do you have some feel as to what type of a rate schedule just won't go in the marketplace, and if so was the Endowment's rate schedule in that class, or was it within the competitive marketplace?

A. *Well, obviously it wasn't without the marketplace, otherwise it wouldn't have sold at all.* But if that case were being covered by Mutual of New York I would have strongly recommended reductions in rates on a regular basis in order to bring in more new lives, because in the long run you must, you know, bring in a steady flow of new lives in order to obtain a favorable mortality result as well as to keep the expense rates down.

Q. Did all of the other plans you compared pass dividends through to members?

A. To my knowledge, yes, either as dividends [1840] themselves or as increase in benefits.

Q. For the other plans, did you compare the margins of gross premiums above the sum of claims costs plus expenses?

A. No, I did not, because that information was not available for the other plans.

Q. Do you believe that an individual shopping for insurance, or in the market to buy life insurance, would be aware of the dividend rates being paid on various plans that he might be considering, or would he be more likely just to be aware of the gross premiums being charged for those plans?

A. Well, he would certainly be aware of the gross premiums being charged. But I would think an intelligent buyer, which you know I presume lawyers would fall into

that category, would be aware of the participating nature of the business and the dividend potentials. In fact I think, you know, many articles in the press have stressed the net cost of insurance, not just for plans of this nature, but in general, you know, cash-value type plans. So I think the population in general is getting more knowledgeable about the cost of money and the net cost of products as opposed to pure gross premiums.

* * * * *

[1883] BY MR. MARKHAM:

Q. Mr. Lindsay, if it is your opinion that the cost of insurance under the Endowment's plan is the gross premium minus dividend, why did you make comparisons based on the gross premium of the Endowment's plan versus the premium net of dividends on the other plans with which you compared it?

A. The real purpose arose from counsel's contention that the government was focusing on that measure. In other words, the gross premium of the ABE plan versus the net cost of other plans. And that is the main reason why I compared plans on that basis, you know, on the limited basis that I did.

Q. Earlier this morning I read to you from paragraph 9 of your affidavit, which I will show you a copy of, which I believe you prepared in connection with summary judgment proceedings in this case.

In that paragraph you stated that "numerous professional groups and associations in the United States sponsor group insurance programs in which any premium refunds are returned to members or are used for their financial benefit. Since the American Bar Association, ABA, has not chosen to do so, those ABA meetings who participated in the Endowment's Group Insurance program have paid more for insurance than [1884] they would

have if the ABA had determined to adopt a program whereby premium refunds are returned to members enrolled in that program."

As I understand your last answer to Mr. Gregory, you no longer think that the cost of the members who enroll in the Endowment's program is the amount that they paid for their premiums; is that correct?

A. Well, the net cost of any insurance program is the premium less dividends; the way of looking at it. And of course the Endowment members have the option—well, they don't quite have the option, but when they signed up for the insurance they elected to contribute any dividend coming back on that coverage to the Endowment.

Q. Correct me if I am mistaken, but I would read the second sentence in paragraph 9 to be a statement that the members are paying more for insurance, and that is because they are paying a gross premium and not getting any refund. Didn't you mean to indicate that the gross premium was paid for insurance?

A. I will admit it is not clear as it could be.

* * * * *

[1929] Whereupon,

WARREN D. GARDNER

having first been duly sworn, was called as a witness herein, and was examined and testified as follows:

DIRECT EXAMINATION

BY MR. DENNIS:

Q. State your name for the record please?

A. Warren D. Gardner.

Q. And your address?

A. 12430 Myrna Road, Kansas City, Missouri.

Q. And what's your age?

A. Forty-nine.

Q. Mr. Gardner, are you testifying here on the basis of a subpoena?

A. Yes, I am.

Q. And have you entered into an expert witness agreement pursuant to the advice of your counsel?

A. Yes, I have.

Q. Are you receiving any compensation from the government in this case?

A. My expenses are being reimbursed by the government.

Q. No other compensation?

* * * * *

[1953] [GARDNER—DIRECT] A. If the association is taking a profit out of the case, it would have the effect of increasing the premium somewhat for the members.

But again, because of the economies of the delivery system itself versus the cost of individual insurance where a commission of 50 percent or so is certainly common, it could be even with the association receiving this remuneration, still could be a good economic purchase for the individual member.

Q. Would the selection process also have an effect on that?

A. Yes, it would have somewhat of an effect.

Q. What about the size of the group?

A. Certainly the larger the group, the more potential market you have, the more volume of insurance you can sell, has an affect on it. Yes.

Q. On the rates charged?

A. Certainly.

Q. Have you had occasion to work with lawyers in purchasing insurance?

A. Yes, sir, I have.

Q. Can you describe what that experience has been?

A. Our company has for some 30 years been the administrator for the Missouri Bar Plan. We were also the [1954] administrator for the Kansas Bar Association.

I personally handled the Missouri Bar account for some six or seven years in the 1970's. As such, I worked closely with the staff of the Missouri Bar, the insurance committee of the Missouri Bar, and as such with many of the individual members of the Missouri Bar.

Q. Would you describe attorneys as sophisticated buyers of insurance?

A. Well, if you're contrasting attorneys in relation to the general population, they are certainly more sophicated than the general population.

In my thinking of the sophisticated purchaser of insurance, my experience says, no, they are not.

Q. And why—

A. Well, there are many reasons. One, they are very busy people. They do not have the time to take and evaluate all the technical aspects of an insurance purchase.

It's been my experience that many of the members of the Missouri Bar, that they don't even read their policy. They really don't know what they have.

We, for instance, we audit. Take and send an audit out every year, telling them what policies and what coverages they have. We do that with all our people, but also with the Bar.

Q. Do you feel that an attorney is capable of [1955] calculating the net cost of his insurance?

A. Certainly some of them are, but I would say the vast majority of them will not have the inclination nor the technical ability to figure out what the net cost of a certain insurance product is.

Q. For association insurance, do you think an attorney lies extensively upon representations made to him in the advertising brochures?

A. By his association?

Q. Yes.

A. Certainly.

Q. This would depend upon the credibility of the association?

A. Well, certainly. Credibility in the marketing of association insurance, the first thing we look at in the association is the credibility factor that association has with their membership.

They have a high credibility factor, you will be more successful than if they have a low credibility factor.

Q. That's a key consideration in your decision whether to come in and market insurance to a group?

A. Absolutely.

Q. Now at my request, have you reviewed the testimony given by Plaintiff's director of publications in this case, Liz Locke, and the advertising materials introduced into [1956] evidence through her?

A. Yes, I have.

Q. Can you comment upon the professional character of the ABE's advertising exhibits?

A. Highly professional. Very good stuff, very attractively done. Very professionally—

Q. Can you contrast that with other association advertising?

A. Well, certainly, of all the association advertising I have seen over the years, it would certainly be in the top percent.

Q. Now, Ms. Locke testified that she used a number of phrases in her advertising materials. Valuable basic insurance designed especially for lawyers. Modest group rates. Economic group rates. Exceptional opportunity to have valuable protection at modest costs.

Are these phrases used over and over again in advertising?

A. Yes, sir. They are—if you want to use the term, "buzz words" in our industry, certainly. You have to understand, Mr. Dennis, that the advertising aspect of direct marketed mass marketing insurance to associations is a very sophisticated and refined business.

These phrases of this type have been tested time and again, and tried time and again. They're in there for [1957] a purpose.

Q. And what's the purpose?

A. The purpose is to get someone to purchase the insurance.

Q. Now would you use the phrase, "This is the best rate on the market"?

A. No, sir, I would not.

Q. Why?

A. Anytime you make a definitive absolute statement like that somebody is going to make you prove it.

Q. Why would that be?

A. Because there is no way that you can take on any given instance and say that you have the absolute best rate on the market.

Q. Are there any laws precluding you from doing that?

A. NAIC model advertising guidelines would specifically prohibit something like that.

Q. State advertising laws?

A. State advertising laws.

That is taking factors you have not gone to the trouble of proving beyond a shadow of a doubt that that is a true statement. If it's a true statement, you can say it. But you have to prove it.

Q. And you'd have to do it before you made the statement?

[1958] A. Some states require prior approval of advertising material.

Q. By the—

A. By the NAIC. Or by the regulator in that state.

Q. In your opinion, is it possible for an association to create a market for insurance through sponsorship, solicitation, promotion and advertising?

A. Yes.

Q. Can you explain how they would do this?

A. By many factors that you would look at. Again. I'll go back to the first one that I talked about a little bit before, and that's the credibility factor that the association has with its members.

If it has a high credibility factor that is very important. Next, you would look at the make up of the association. What is the membership's profession? Is it a highly desireable profession that the insurance industry wants to reach?

Secondly, is it a large association and does it have a substantial number of the overall members of the profession in the association.

All those aspects are true. Certainly the association can, in fact, make a market.

* * * * *

[1977] [GARDNER—CROSS] Q. You were provided application forms for the insurance policies?

A. Yes.

Q. Were you provided by the government any documents concerning the history of the insurance program?

A. What do you mean by the history, sir?

Q. Do you recall any documents called, "The Endowment Story"?

A. I don't recall any one especially like that, no, sir.

Q. Do you recall the government showing you the annual notice to members of contributions by insured members?

A. I saw one that was a copy where there was a—oh, maybe like a three by eight card or something of this type, that had percentages of contribution to the membership.

Q. Let me show you what has been marked as Exhibit 201, and ask if that is the card you're referring to?

A. I'm not sure it's this exact one. I think the percentages on the one I saw were a little different, but it's certainly similiar to this. Yes, sir.

Q. And that refers to a percentage that the Endowment calls a contribution to the Endowment. Is that correct, sir?

A. I think it's called, "tax deductible portion of [1978] premuim."

Q. In the body of that card talks about a percentage contribution made by Endowment members to the Endowment. Is that correct?

A. It—made a contribution to the Endowment. Yes, sir.

Q. And that card is 1979. What percentage figures are shown on that card?

A. Forty-point-five percent of any life insurance premiums.

Q. And now would you list for me, Mr. Gardner, the other association groups that you're aware of that send a similar card to their members at the end of the year?

A. I'm not aware of any other associations that send a similar card of this type to their members.

Q. Is it not a fact, sir, that this card discloses what you've described as profit, on the part of the Endowment to the members?

A. Yes, sir.

Q. Would you please name for me the mass marketed insurance programs of which you are aware that send by separate mailing each year a statement of the profitability of the program for those insured under the program?

A. I'm not sure I understand your question. Of any association plans that report on the financial aspects of [1979] the plan to their members?

Q. That wasn't my question. Let me see if I can't break it down with a bit more precision for you.

It was quite a bit of confusion in the testimony concerning mass marketing, association, et cetera.

Let me direct your attention to professional association. You used "association" generally. I'm going to talk a lot about professional associations.

Please list for me professional associations of which you are aware that report to the members each year on a separate mailing exactly the amount of dividends retained by that association.

A. I know of no others.

Q. And, of course, you don't know of any credit card program that discloses anything about its profits to the insured members. Do you?

A. No, sir.

Q. And you don't know of any credit life insurance program that would disclose the amount of profits to the insured member—to the insureds on an annual basis, do you?

A. I do not.

Q. Because that is inimical to the marketing strategy of credit life insurance. Is that not correct, sir?

A. It certainly is one of them, yes, sir.

* * * * *

[1988] [GARDNER—CROSS] A. That's a possibility.

Q. Is it not a probability?

A. Not always.

Q. Would you expect the same percentage of premiums paid on a 15 million dollar case as on a 100,000 dollar case?

A. There are some that are.

Q. All right. Give me an illustration.

A. There would be an example—you're asking for a specific association?

Q. Yes, sir.

A. I cannot give you a specific association, Mr. Gregory.

Q. Does Forest T. Jones Company administer the Missouri Bar insurance plan?

A. Yes, sir, they do.

Q. And this is a major medical plan, sir?
A. It is.
Q. Would the initial deductible of about 2500 dollars?
A. No, sir.
Q. All right. What is the deductible?
A. There are various deductibles, starting at 200 dollars.
Q. The option on the part of the members?
[1989] A. Yes, sir.
Q. And Missouri Bar is a professional association?
A. Yes, sir.
Q. And the National Society of Public Accountants was a professional association?
A. Yes, sir.
Q. And was that plan in existence when you were at Forest T. Jones?
A. Yes, sir.
Q. Is it not a fact that the average premiums were approximately the same as the National Society of Public Accountants?
A. I would have no way of knowing that.
Q. Well, were you familiar with that plan when you were at Forest T. Jones?
A. I was familiar with the plan.
Q. One-point-one million average, sound strange to you?
A. Probably not.
Q. Now this is strictly a major medical plan.
A. It is strictly a major medical plan.
Q. And with deductibles as low as 250 dollars?
A. That is correct.
Q. So at least at that level, that's certainly not a catastrophic major medical plan?
[1990] A. That is right.
Q. At least with some people.
A. You're using the word "catastrophic" in relation to excess?

Q. Excess. This primary coverage at 250 dollars?
A. That is correct.
Q. And primary coverage, at least what I would describe as first dollar coverage. Is that a fair statement?
A. Fair statement.
Q. All right.
And about one-point-two million or so in premium. Can you recall what the average brokerage commission would be for Forest T. Jones on that case?
A. It's higher for new business than it was for renewal. And I'm thinking somewhere, maybe in the area of 10 percent new business, five percent renewal.
Q. Would it surprise you if the average brokerage commission over a three year period were seven-point-five percent?
A. No.
Q. And would it surprise you if the service fee averaged over a three year period about nine percent?
A. No.
Q. And that's 16.5 percent to Forest T. Jones?
A. That's correct.
[1991] Q. And that includes payment for claims administration?
A. That is right.
Q. Now what, if anything, do you know about the dividend history of the Missouri Bar plan?
A. I know of nothing on the dividend history.
Q. Now is it experience rating?
A. Yes.
Q. And do you know how dividends have been applied?
A. If there were any dividends payable, they would have been applied back to the benefit of the members.
Q. Members of the association?
A. Yes, sir.
Q. Not to the bar?

A. No, sir.

Q. And New York Life paid no compensation to the Missouri Bar for sponsoring this plan?

A. That is absolutely correct.

MR. GREGORY: I'm going to go into a different subject, Your Honor. Would it be convenient to break now?

THE COURT: That'll be—

See you at 2:00.

(Whereupon, at 12:00 Noon, a luncheon recess was taken.)

* * * * *

[2015] [Gardner—Cross] Q. What about disclosure of the substance of the program? What's done with the money?

A. They are not similar.

Q. They're entirely different, isn't that correct?

A. I would say so.

Q. And, it's also entirely different from association groups that don't talk about what happens with any profit retained by the association, isn't that correct, as far as disclosure is concerned?

A. As far as disclosure is concerned?

Right. It would have to be different.

Q. That's right, because the American Bar Endowment discloses all aspects of the financial operation of the insurance program and credit card insurance discloses none to the consumer except the gross premium, is that correct?

A. That's correct, but does that have any ultimate affect on the price of the product?

Q. I'm going to show you, sir, a document which has been designated as Exhibit 376. This is in evidence. Let me show you the one that is actually the document, your Honor.

THE COURT: I think I have one of these.

MS. CARPENTER: If Judge Kozinski does have one, [2016] maybe the witness would want to look at it.

THE COURT: Why don't you give this one to the witness.

MR. GREGORY: Thank you.

BY MR. GREGORY: (Resuming)

Q. I'm going to ask you, sir, to just look at that brochure and open it up, turn to the page, the purpose. Just read that page.

(Pause)

A. Yes, sir.

Q. Now, would you turn to page three and there's a box. In the box it says that there's a special enrollment period which will terminate October 15, 1972. Now, do you think it's logical for us to agree that this brochure was distributed prior to October 15, 1972?

A. I can almost bet it was.

Q. I wouldn't take the bet. Can you name one other insurance program, any kind anywhere in the association group credit card area and we'll toss credit life or credit ANH right into the hopper on this one, that has ever come even close to making this kind of disclosure of what would happen with dividends and experience credits?

A. I think we've discussed it before. I could not name one.

* * * * *

[2020] [Gardner—Cross] Q. And in a forthright manner?

A. I would think so—I would hope so.

Q. And ordinarily wouldn't lie when he testifies as to what his services have been priced at and why?

A. Lie?

Q. Yes, not tell the truth to a client?

A. I would hope so.

Q. You would hope that he would not?

A. I would hope that he would not.
Q. Because you wouldn't, of course not?
A. I wouldn't.
Q. As I understand your expertise and have concurred in it, I might add, as you heard, you're an expert consultant in the area of association group insurance?
A. I would say so.
Q. Let me take you back to 1981. You've gained some familiarity with the American Bar Endowment Plan. How would you have advised the American Bar Endowment to go about selecting a third party administrator in terms of the cost of service?
A. I would developed a set of specifications of all the services that the third party administrator would be expected to perform, each one carefully defined and I would insist that the quality of service be equal to or greater than [2021] the present quality of service that the buyer was furnishing. I would obtain information regarding at least the top ten or twelve administrators in the country and I would give that exact set of specifications to each one of them. And, in addition, I would insist on a long-term agreement with very definitive escalation clauses for the increase in the remuneration to that organization.
Q. And you'd ask these organizations to come in and present, in effect, a competitive bid?
A. That is correct.
Q. Because the ABE insurance plan is large enough that it can be put out in terms of third party administration for a competitive bid?
A. You would have them knocking in your doors.
Q. Because of the competition in the industry?
A. Right.
Q. And, every one of them wouldn't come in at 25 percent of premiums, would they?
A. No, they probably wouldn't come in at three and a half either.

Q. Pardon me?
A. They probably wouldn't come in at three and a half either.

* * * * *

[2029] [Gardner—Cross] A. Should be.
Q. Now, you looked before, and in fact told me that you had seen an annual notice from the American Bar Endowment to insured members showing percentage of premiums that had been retained by the Bar as charitable contributions?
A. That is correct.
Q. Now, were you informed by the United States that the American Bar Endowment has been forwarding these notices each year since 1964?
A. I was not informed they had been forwarded each year since 1964.
Q. We'll just assume that. Let's assume that for purposes of my questioning. And, assume that it comes first-class mail. Assume that it's an envelope with nothing else.
Do you think a lawyer is capable of opening the envelope and reading what's on the card?
A. He certainly is capable.
Q. Do you think a lawyer is capable of taking those percentage figures and applying them against his prior premium payments to determine what those percentage figures represent?
A. He's capable.
Q. Do you think if the percentage figures are in the range of 40, 50, 60, 70 percent a lawyer might be motivated to do that?
[2030] A. I think he might be motivated.
Q. Do you think if a lawyer took the premium figures, applied the appropriate percentages, he'd be capable of subtracting that figure from his prior premium payment?
A. Should be.

Q. Do you think a lawyer knows what the American Bar Endowment has retained as dividends and experienced credit?

A. I think so—most of the advertising material at different times tells him that.

Q. I'm going to ask you just a few questions about individual insurance and group insurance. Can you state to me the essential differences between individual insurance and say association group insurance?

A. In individual insurance, the point of sale takes place between the consumer and a broker or agency. The policy that he buys is his individual policy and he selects an amount of insurance to fit his particular needs.

Q. Can you think of any other essential differences?

A. Normally the cost of the product is substantially higher than group insurance.

Q. Is it not also a fact, sir,—Let's look at life insurance. In individual life insurance, the cost of the product is guaranteed in many cases?

A. Yes.

* * * * *

[2045] [Gardner—Redirect] A. Certainly if they're members of the state and local bar associations, other national bar associations, and they are the same individual, they're competing for the same insurance dollar.

Q. Does the ABE in marketing its insurance compete with employer-employee plans?

A. No, not on a direct basis.

MR. DENNIS: No further questions.

MR. GREGORY: Just very briefly, Your Honor—

RECROSS EXAMINATION

BY MR. GREGORY:

Q. Mr. Gardner, did I understand you to say that this Master Educational Trust went to New York Life on August 1, 1983?

A. Yes, sir.

Q. Let me make sure I understood your cross examination on one point. You're saying that because the members of the American Bar Endowment sign an initial application agreeing that the dividends to policyholders and experience credits will be retained by the endowment for charitable purposes, that that means their cost of insurance is the gross premium?

A. In my opinion, yes, sir.

Q. And you're saying that makes the entire dividend, experience, compensation to the Endowment?

[2046] A. No, not the entire.

Q. The dividend less the expenses?

A. Expenses of administration and marketing.

Q. All right. Now, I think you said that the Bar could consider or might consider—Again, I don't want to put words in your mouth.—an annual option in the members to keep the dividend. Now, if there were an annual option where a member had the option to keep the dividend, you would agree then that the member really did have a net cost equal to the gross premium minus the dividend?

A. If he had the absolute option, yes.

Q. All right. And the American Bar Endowment, in your understanding, receives compensation from no person in the world other than that represented by the dividend and the experience credit?

A. That is true.

Q. Now, if there were—Stay with a short hypothetical with me, please. If there were an annual option on the plan and every member opted to allow the Bar to keep the dividend and experience credit and not a single member asked for it back, would you not agree that the members had made a charitable contribution?

A. You're talking legally as a definition of a charitable contribution—I couldn't address that. From my understanding [2047] of it, certainly.

Q. So, what distinguishes the charitable contribution from what you say is millions and millions and millions of dollars of compensation is the annual option versus the signature of the individual lawyer at the time the application for insurance is made?

A. That's right.

MR. GREGORY: No questions.

MR. DENNIS: Just one more question.

FURTHER REDIRECT EXAMINATION

BY MR. DENNIS:

Q. Has the annual option method been used in the mass marketing insurance?

A. It was a marketing thing a lot of us tried back in the mid-'70's as a sales tool to get an association to adopt an insurance program. We would say, – And, we'll set this up so the association can receive any dividends that would accrue and it was a dismal failure.

Q. No one would assign their –

A. Nobody's still doing it. If it had been successful, we'd still be doing it.

MR. DENNIS: No further questions.

* * * * *

[2089] MR. WATKINS: Your Honor, at this time the Government calls Mr. James Burnett.

Whereupon –

JAMES BURNETT

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. WATKINS:

* * * * *

[2093] Q. Do you read it?

A. Not anymore. Very infrequently. I sometimes peruse it. But when I was in law school I read it regularly.

Q. Do you ever recall reading reports of the American Bar Endowment in the Journal?

A. I seem vaguely to recall they may have been there. I doubt I read them, because I doubt I had that much interest in them.

Q. Do you ever recall seeing advertisements by the Endowment in the Journal?

A. No.

Q. Have you ever considered dropping your American Bar Endowment membership?

A. Yes, I did in 1981.

Q. Did you in fact drop that membership?

A. No, I did not.

Q. Would you tell us why you did not?

A. Well, I didn't want to lose the insurance programs that I had through the American Bar Association.

Q. What programs are you insured under?

A. Best of my recollection, I have a life insurance policy which I think is $20,000 in amount. And I have a major medical plan that kicks in over [2094] $10,000, it begins. I also think I have an accidental death and disability plan.

Q. Did you ever try to buy more life insurance under the American Bar Association program?

A. Not to my recollection.

Q. When you purchased the life insurance under the Endowment were you required to submit any evidence of medical insurability?

A. I may have filled out a form. But I remember one of the reasons I was interested in the policy was that I did not have to have a medical.

Q. Why was that important to you?

A. Well, because some people believe that I am overweight, and I have been concerned about my insurability because of that.

Q. Did you ever try to apply for other life insurance?

A. At one time I applied for a policy through Woodmen of the World through which I have some other insurance that would have allowed me to, I think the marketing phrase was insure your insurability by a specified, per being able to purchase a larger amount of insurance without medical. And I wanted to be sure that I had the option and after making the application they rated me up and I thought it was marginally too [2095] high and I did not take it.

Q. Would you explain what you mean by rated you up?

A. They were going to let me buy the insurance but make me pay a higher rate than I was told that I would have to pay originally.

Q. Do you consider the price you pay for the Endowment's insurance reasonable?

A. Yes.

Q. Have you ever held any higher insurance under the Arkansas Bar Association?

A. Yes, I believe I have 20,000 under that.

Q. Do you know whether you receive any experience rating refunds from that policy?

A. I don't believe so.

Q. When you applied for the Endowment's insurance were you aware that the American Bar Association took the position, on the advice of their tax counsel, that you could take a charitable deduction for part of your premium payments?

A. No.

Q. Did you learn of that at some later time?

A. Well, when I began to receive these little statements that I was entitled to deduct some things, something like that, I became aware there was some tax [2096] issue that related with it, but not understanding tax law I didn't pay a whole lot of attention to it.

Q. What did you do with those notices?

A. Threw them in the waste basket.

Q. Do you itemize deductions on your federal income tax return?

A. Again, not understanding tax laws, I am not sure what you mean itemize deductions, but I think you mean would I state a specific amount for contributions. And yes, I suppose perhaps I have at different times itemized and maybe times I have not itemized.

I know I have in some cases.

Q. Have you ever deducted, as an itemized deduction, any amount attributable to your participation in the Endowment's insurance programs?

A. No.

Q. When you purchased your life insurance was your sole motive to obtain insurance coverage?

A. Yes.

Q. Was that also true with the major medical and accidental death and dismemberment coverage?

A. Yes.

Q. At one time did you hold insurance coverage under the disability and hospital indemnity policies as well?

[2097] A. I don't recall holding the hospital indemnity and disability policy. However, during depositions I was presented with the form that indicated that at one time I did. But my recollection other than knowing that it is true from that documentary evidence is not-existent on that.

Q. Assuming for the moment that you did, would your motive in buying that—would your sole motive in purchasing that coverage also have been to obtain insurance coverage?

A. Yes.

Q. If you had a choice would you rather receive the premium refund yourself?

A. Yes.

Q. Have you ever contributed to the Arkansas Bar Endowment?

A. Yes, I have.

Q. Apart from your participation in the Endowment's insurance program have you ever made any contributions to the American Bar Association?

A. Not to my recollection. I may have, because I contributed in small amounts to a lot of various entities in my life and that could be one of them.

* * * * *

[2101] A. Yes, I would. I don't think I could have altered the terms there even if I had wanted to.

Q. I beg your pardon?

A. I don't think I could have negotiated or altered the terms and that would be what I consider boilerplate.

Q. Now, you recall, I believe, getting regular notices from the American Bar Endowment indicating that you had made certain contributions in certain percentage of your premium payments?

A. Yes.

Q. And I believe you testified that you regularly threw these into the waste basket?

A. Yes, I did.

Q. And did I understand your testimony on the deposition that you considered these amounts of these contributions rather negligible?

A. As I recall, they were not large. At least I didn't think they were large enough for me to pay a tax accountant to figure out what to do with them.

Q. It just wasn't worth it to figure out what was the amount of your contribution?

A. Yes.

Q. Did you have a general understanding of the charitable purposes of the American Bar Endowment?

[2102] A. Yes, I had been to at least a mid-year meeting and also an annual convention of the American Bar Association, at which I know the American Bar

Association is discussed. And I think maybe I have seen reports and things that have been drafted under their auspices or research done, so on.

Q. Let me read from the charter and see whether their statement of purpose accords with your general understanding, if I can find Exhibit No. 267.

Was it your general understanding that the American Bar Association was a charitable organization to help to direct toward broadly improving the administration of justice in the United States?

A. That is correct, improving the quality of the bar.

Q. I understand from your testimony this morning that if you could have gotten your contributions back you would rather have had them than to have had them go to the American Bar Association?

A. Yes. And then if I wanted to contribute to the American Bar Association I could have done so. Or I might have taken it and contributed it to the Arkansas Bar Endowment so that I would have had more direct benefit to my home state and community.

Q. Is it correct then to say that you were [2103] happy to enter into the charitable program sponsored by the American Bar Association but were not happy to make the contribution that that entailed?

A. Well, I didn't resent the fact that whatever money was coming back would go to the American Bar Association. Given that if I had had a box to check, I would have checked to have it come back to me.

Q. Is it correct that you indicated in your deposition that the Government would have difficulty in proving that you were a typical attorney insofar as this insurance was concerned?

A. I hope that it is true, that they would have a hard time proving that I was a typical attorney.

MR. THROWER: Well, I have no further questions, thank you.

MR. WATKINS: We have no further questions. Mr. Burnett is a busy man as Chairman of the Board and we appreciate his appearance here today and thank him for his time.

THE COURT: Thank you for your testimony, Mr. Burnett, you are excused.

(Witness excused)

THE COURT: Why don't we take our quick mid morning break, about ten minutes.

(A brief recess was taken.)

[2104] MR. DENNIS: Your Honor—

THE COURT: Was Exhibit 152 moved into evidence or anything like that?

MR. THROWER: No, Your Honor, that was not offered in evidence.

MR. DENNIS: Your Honor, the next witness we would like to call is Angele Khachadour.

Whereupon—

ANGELE KHACHADOUR

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

Direct direct

BY MR. DENNIS:

Q. Would you state your name, please?

A. Angele Khachadour.

Q. And your address?

A. 817 Ridgeview, Mill Valley, California.

Q. Ms. Khachadour is testifying as an expert witness for the Government this morning, Your Honor.

Are you receiving any compensation—

MS. CARPENTER: Excuse me, Your Honor, she will not be testifying as an expert unless our objection is overruled.

THE COURT: He will offer the witness, I think is what Mr. Dennis meant to say.

* * * * *

[2199] BY MR. DENNIS:

Q. What is the net cost of the ABE insurance?

A. To the buyer, to the member?

Q. Yes.

A. It is whatever the member has been charged for the coverage.

Q. Gross premium?

A. Yes.

Q. When you said that the ABE insurance would be a good buy for the member, if the dividend levels were 50 percent would that affect your statement that it is a good buy or could the ABE still provide reasonably priced insurance at that level?

A. My opinion that the product is a good price product is based on what like products are sold for in other group cases. If I compare the ABE life program with the California state bar program, depending on sex and age at the time of entry, I think the comparison would be two products of like value to the member.

So if you are telling me there are dividends of 50 or 60 percent, which makes me choke, still the product in comparison to whatever else is available in the marketplace is good. I look at the value of a program based on what else I can buy.

* * * * *

[2209] CROSS-EXAMINATION

BY MS. CARPENTER:

Q. Ms. Khachadour, your task force ultimately determined to treat association groups in a way different from credit card and other discretionary groups; is that correct?

A. That is correct.

Q. And you made a reference in your direct testimony to good guy associations and bad guy associations. Do I understand correctly that the good guy associations were

treated like employer-employee and multiple employer trust groups and the bad guy associatioons were treated like the discretionary groups; is that correct?

A. It depends, counsel, as to whether the association fit the particular standards of eligibility in that section. If it was in existence for a period of time, if it had dues, if it had by-laws, articles, so forth, it was kind of presumed to be a good type association.

Q. And those criteria would be an association in existence more than two years, formed for purposes [2210] other than obtaining insurance, its by-laws or constitution provided it meet at least once a year, that it collect dues or solicit contributions from its members, that its members have voting privileges and that its members have representation on governing boards of the committees; is that correct?

A. That is correct.

Q. That is what you refer to as a good guy association?

A. Presumed to be a good-guy association.

Q. Presumed to be.

A. Yes.

Q. You had a colloquy with Mr. Dennis about solicitation and selling and you made reference to the fact that only a licensed agent or broker can solicit or sell insurance. Is that correct?

A. Technically, yes.

Q. Is my understanding correct as well that only a licensed agent or broker may receive a commission for selling insurance?

A. Yes.

Q. Do I understand that an association that was not—did not meet the good guy criteria would have to provide benefits that were reasonable in relation to premiums charged?

[2211] A. Yes.

Q. And that was a response to abuses by certain associations and discretionary groups in terms of receiving excessive compensation?

A. Well, the definition of discretionary group, counsel, was a major liberalization of the law. The law was not saying that any kind of grouping is acceptable, however where the group is of such a nature that the organization involved may not have the best interest of the members at heart then we will add this additional standard that the benefits be reasonable in relation to premium charged.

Q. I understand from the report of your task force that there was concern that sponsors of some groups were getting as much as 15 to 20 percent of premium?

A. Yes,

Q. And that was perceived as abuse by your task force?

A. Yes.

Q. Dividends and experience credits are not always compensation under every circumstance, are they?

A. No.

I mean yes.

Q. What?

[2212] A. Yes, that is a true statement.

Q. One of the remedies for reverse competition is full disclosure, is it not?

A. One of the remedies touted by some is full disclosure. I have become very skeptical as to disclosure as remedy.

Q. And another remedy for reverse competition is control by the insured individuals, is it not?

A. Yes, the insured doesn't have to buy the product of course.

Q. And if the insured has control over the organization that serves its group policyholder, that can be one remedy for reverse competition, can it not?

A. Yes.

Q. You used the word "middleman." Where did you get that word?

A. It is an English word, is it not?

Q. Yes.

A. Where did I get that word?

Q. Would you agree it is not a word one ordinarily hears in the insurance industry, the word middleman?

A. I would use it. I have used it a lot to describe the third party intermediate who acts as the source of the insurance for the consumer.

[2213] Q. You testified on direct that generally group insurance is lower in price than individual insurance. Now, are you aware that there has been a very significant decline in the price of individual term life insurance?

A. Yes.

Q. In the credit insurance area. I believe that since the abuses of the 1960's which you discussed, profits of credit insurance companies have been limited by law or regulation, isn't that right?

A. In some states.

Q. And that would include California?

A. Yes.

Q. And those are situations in which there is no control by the debtor of the organization that is providing the insurance?

A. Yes.

Q. And in fact the debtor needs something from that organization, doesn't he or she?

A. Yes.

Q. And there is no disclosure of the profit made on the credit insurance?

A. No.

Q. And there is no disclosure even of the fact of the dividend or experience credit, is there?

[2214] A. No.

Q. Is the reason that the regulatory authorities in some states, including your own, have moved against credit insurance profits the fact that those profits were viewed as excessive?

A. Yes.

Q. And in fact, those profits were viewed as so excessive as to be inappropriate and unethical?

A. Yes.

Q. It is true, is it not, that many professional associations take no money out of their insurance programs?

A. Yes.

Q. And in fact they try to make their insurance programs as cheap as possible?

A. Yes.

Q. And in fact provide their members with very low priced insurance?

A. Not necessarily, depending on the size of the group.

Q. A reasonably large group can provide insurance at very favorable prices, can it not?

A. Certainly.

Q. And some of those associations advertise to their members their past dividend history, do they not? [2215] Always, of course, with the caveat that dividends are not promised, but they do tell the members about past dividends that have been returned?

A. I have seen very few of those. I think the ABE is the exception that does show that. I can't remember seeing association advertising past dividends, no.

Q. Have you ever seen advertisements for the Engineering Associations Trust?

A. No.

Q. Or the Ontaria Medical Association?

A. No. There are hundreds of thousands of associations. In California, at least, I have not seen any.

Q. I understood you to say on direct that compensation is anything of benefit to you for giving business to the carrier. That was a general statement not in the context of the ABE. But I want to be sure about one point. Did you mean to imply by that that New York Life is paying the Endowment three, four or five million dollars a year to bring the Endowment's business to New York Life?

A. I should say so.

Q. I think you said in California the profits of credit insurance are limited to 15 to 25 percent; [2216] is that correct? Did I understand you?

A. Yes.

Q. And do you view as anything more than this percentage to be excessive profits?

A. I think we range as high as 32. Depending again. The commissioner deemed anything in excess of that to be excessive, yes.

Q. What did you review in preparation for your testimony today?

A. Not much. I was asked if I had ever seen the bulletin, director bulletin of Illinois, and I remembered it.

I was asked to identify the ruling from California. The NASC report. I was shown copies of the reports I have written as the task force representative on group life and health models, that is about it.

Q. Was the last time you saw an Endowment Brochure 10 or 12 years ago?

A. No, I saw the brochure last year. I received one of the solicitation packages last year.

* * * * *

[2219] A. If I have an option to receive the dividend, then after my receipt of the dividend my cost would be the premium I paid at the beginning of the year less the dividend.

Q. You said a dividend in the 50 to 60 percent range would make you choke. Why is that?

A. I can't imagine the rationale for justifying such a dividend.

Q. Did you know a Mr. Theodore Slokum?

A. No.

Q. Do I understand your testimony correctly that there was no consensus reached in your task force with respect to what to do about compensation of group policyholders?

A. That is right. Primarily because it was not the task force's charge at that point when we were considering it.

Q. Do you know anything about the history of the ABE program?

A. You mean its early—

Q. Its origin.

A. Not really, no.

Q. You made some reference to the fact that you didn't think that lawyers read their material. Is it your view that lawyers need to be protected from [2220] themselves in entering into group insurance arrangements?

A. No. That is why we did very little about this and other programs from professional associations.

MS. CARPENTER: If you don't make your plane, talk to Mr. Dennis. That is all, Your Honor.

THE WITNESS: I thank you.

REDIRECT EXAMINATION

BY MR. DENNIS:

Q. On cross-examination, the question was asked dividends were not always compensation. When would dividends not be compensation?

A. In an employer payroll program dividends or refunds to the employer is not compensation, it is just the reduction of the premium the employees paid.

Q. And you also indicated that it wouldn't be compensation if it weren't required as a condition of entering into the program, the payment over to the group policyholder?

A. Yes, I would not view it as compensation at that point, no. If I have an election as to what I do with a dividend, my own certificate or my own policy generates.

Q. On the other hand if the member didn't have an option but as a condition of entering the program [2221] was required to waive, then you would feel it was compensation?

A. Yes.

Q. Counsel on cross-examination asked you a series of questions about distinguishing between discretionary groups and association groups, talking about situations where an association—where the member might have some control over the organization.

A. Yes.

Q. Do you feel that in a large group like ABE the member has any effective control over the organization?

A. Yes.

MS. CARPENTER: Objection, no competence to answer that question.

THE REPORTER: Your Honor, I got the witness's answer at the same time as the objection.

THE COURT: I didn't hear the answer.

THE REPORTER: I had a yes answer, Your Honor.

MS. CARPENTER: Your Honor, forget it, the witness has a plane to catch. Let's get her out of here.

MR. DENNIS: I will strike the question from the record.

[2222] THE COURT: The answer must have come in the wrong way, Mr. Dennis.

THE WITNESS: I think so.

BY MR. DENNIS:

Does the member of the ABE in purchasing insurance need something from the ABE?

A. Need something? What do you mean?

Q. Well, counsel asked you a question attempting to distinguish association insurance from credit insurance where on credit insurance the member needs something from the creditor, the insurance, whereas is that true of association insurance?

A. Well, it is not quite the same thing. A member of the association is not quite at the mercy of the association as a borrower would be when faced by a stern banker who doesn't want to lend him anything.

Nevertheless the mere fact that the member is buying from the association assures they have a need to have access to association coverage.

Q. In the NAIC Bill you stated that benefits must be reasonable in relation to the premium charged; is that correct?

A. In the discretionary group, yes.

* * * * *

[2305] Whereupon—

RUSSELL L. SIDERS

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. DENNIS:

Q. Would you state your name, please?

A. Russell L. Siders.

Q. And your address?

A. 346 South 124th Street, Omaha, Nebraska.

Q. Who are you employed by?

A. Mutual of Omaha Insurance Company.

Q. What is your current position?

A. Vice-President in the group operation.

Q. Is that the True Group Operation?

A. It is not called that, it is just called the group operation.

Q. And it deals primarily with employer groups?

A. Well, that is one of the products of group operation, yes. It would include pensions, group health insurance, life insurance, et cetera.

* * * * *

[2383] Q. I think you say that logically "we would not want to increase premiums over the 85 cents mark as—

MS. CARPENTER: Excuse me. The witness did not say that. Mr. Breiner said that.

THE WITNESS: Yes.

BY MR. DENNIS:

Q. But you would agree with that statement?

A. Well, I would agree that you wouldn't want to price yourself out of the market. If that was the determination in going above 85, would do that, I would say logically you would not want to do that, no. Not that you didn't have to.

Q. So in pricing a product you would not attempt—for the ABE product you would not attempt to get the rock bottom price but you would still want to remain in the market range; is that correct?

A. I guess on a reading—well, yes, I would say that is a logical approach. I would say the rate isn't necessarily determined by the insurance company. We make a study, we make recommendations, we make suggestions and then the board makes the determination as to what they want the rate to be.

* * * * *

[2413] MR. DENNIS: Mr. Barnhart is our next witness, Your Honor.

THE COURT: Call Mr. Barnhart.

Whereupon—

E. PAUL BARNHART

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. DENNIS:

Q. State your name, please?

A. E. Paul Barnhart.

Q. And your age?

A. I am 57.

Q. Mr. Barnhart, I have asked that you prepare a summary of your professional experience for the Court.* * *

* * * * *

[2495] Q. Do the brochures set forth the statement about what the Endowment is going to use the funds for, the dividends for?

A. Yes, in general. The literature describes the purposes and activities of the Endowment, and the fact that any dividends returned to the Endowment will be used for these exempt purposes, primarily research and scholarships.

Q. And you are aware of the fact that notices are sent to members advising them about the level of dividends?

A. Yes, I am.

Q. Can you describe the level of dividends on the American Bar Endowment program?

A. In terms of their magnitude?

Q. Yes.

A. The general magnitude of those, yes. On three of the programs the dividends tend to be quite substantial, running in the general range of 30 to 50 percent or more. On the life program, the disability program and the hospital, in-hospital program, which is called the ESP program.

On the other two, the average performance in terms of returning dividends has been much less.* * *

* * * * *

[2520] Q. Could you state for the Court what those opinions are?

A. *First of all I find all five of the programs to be definitely competitive.* The life program, the major medical program and the disability program the most so. In the analysis I made I generally rank those three to be in the lower third of the general competitive marketplace in which they are offered.

The in-hospital program, the ESP program and the ADD-250 program are priced at a more average level. I would say I place them in the middle third, they about in general fall in the middle third of the marketplace in which I see those plans being offered.

So I deem them all to be competitive as to benefits and price with the life, the disability, and the major medical being the most relatively most competitively priced.

Q. Was the analysis that you made similiar to the same type of analysis that you would make for an association that you consult with, or an insurance carrier concerning the credit card or mass-market insurance?

* * * * *

[2546] A. * * * If anything, had accidental death been available it probably would have been at a higher premium than used here for the adjustment.

Then the Ohio plan operates on a basis where it gives the member the option of either crediting his dividend against the next year's premium or donating it to the Ohio State Bar Foundation. The members are given an option of which of two ways they can apply their dividend.

Then the Oklahoma rates here also show net rates, they show the gross rate and also the net rate. And effective in 1977, and as near as I can determine from the information available that had continued to be in effect, that a 25 percent dividend was credited to the next year's premium. So again the gross rate shown is the going-in rate to a new member and the second year he would pay a rate discounted 25 percent as a renewal premium.

Then taking up the same matter on Exhibit 3, here the waiver of premim was included in these credit card plans that are shown here. Also this Airline Passenger Association plan.* * *

* * * * *

[2579] A. * * * So it is quite clear that not only in theory but in actual fact the Bar Endowment has been at risk, and there are these two examples of administrative and marketing expenses not being covered by the dividend paid. And because of this the fact that the Bar Endowment's gross dividend return is very much at risk up front, the Bar Endowment is actually functioning here as the insuror and the insurance companies are actually functioning as reinsurers. Their role is exactly the same as the role of a reinsurer providing stop loss coverage under, say, something like an individually insured plan written by a commercial insurance company. The commercial company takes the up front loss up to a certain point and when the stop loss threshold is reached the reinsurer begins to assume the risk and that is exactly the role that is in fact being played by New York Life and Mutual of Omaha here.They are actually functioning as reinsurers, whereas the Bar Endowment is functioning as the insuror, as the primary insuror.

* * * * *

[2610] A. That is now with John Hancock, I believe. I am no longer working with the American Optometric Association. They were insured with New York Life during the time I was their consultant.

Q. Both large mutual companies?

A. Yes.

Q. And a lot of large professional associations tend towards the large mutual companies; is that correct?

A. Quite a number, yes.

Q. And the dividends payable by John Hancock or New York Life either would be used for stabilization reserves or to reduce the premiums of the members?

A. Largely. There is also an expense allowance paid to the AOA. I am not clear on what—I don't recall exactly what that was, but I think in the nature of five to seven percent. I believe. And it differed on the life program as compared to the other programs.

Q. And they perform services in connection with the administration of the program?

A. Yes. Yes, that was to reimburse the AOA for various administrative services provided.

Q. The American Psychiatric Association, who underwrites that plans?

[2611] A. That is underwritten by Mutual of New York.

Q. And dividends are handled how?

A. Dividends are handled again in the same way, they are—well, here again there is an expense allowance, although it is very small, paid to the APA. And beyond that dividends that are declared are used to reduce members' renewal premiums.

Q. Expense allowance is for the services provided by APA?

A. Yes, directly in connection with the member insurance programs.

Q. Health Insurance Association of America is a trade association?

A. That is a trade association, yes.

Q. I was not sure what Illinois Health Improvement Association is?

A. It is an interesting and rather unique organization. It is what I would call a consumers' association. What it is composed of primarily are farmers and rural businessmen, small town businessmen. It is kind of an out of state

Illinois consumers' association. It has been in existence since 1948. It has been there a long time. And it has life insurance and health insurance in force.* * *

* * * * *

[2617 Q. Do I understand correctly that Exhibit 1410—I only have one copy—summarizes the list of documents and sources that you relied on, at least principally if I understand your testimony?

A. Yes, the principal sources of information that I actually ended up making use of.

Q. You stated an opinion yesterday that dividends and experience credits received by the Endowment constituted compensation; is that correct?

A. Yes.

Q. What have you read to give you any background concerning the history of the Endowment's insurance program?

A. Well, I have read I think primarily stipulation records that give a summary of the history of the Bar Endowment program.

Q. You read the stipulations filed by the parties; is that correct?

A. That is correct. And in the course of going through documents a number of memoranda, reports, [2618] minutes of committee meetings, and things of that nature.

Q. Did you make any systematic attempt to investigate the origin of the program in terms of its purpose?

A. Yes, I am familiar with that at least in a general way.

Q. Why don't you take out Exhibit 1410 and direct me to anything that you said you principally relied upon in that document that would help you understand the history and purpose of the program?

A. Well, I have not relied on the history and purpose of the Endowment program itself in forming my opinions on a case.

Q. So you formed your opinion as to compensation without relying upon the history and purpose of the Endowment programs?

A. That is correct.

Q. And you formed your opinion as to compensation without reviewing the testimony of Mr. Ron Foulis and the exhibits introduced in connection with his testimony; is that correct?

A. That is correct.

Q. And you formed your opinion on compensation without any systematic attempt to determine what the [2619] Bar has told its members over the last 28 years about the program; is that correct?

A. That is correct, sir. I don't believe what the Bar has told its members necessarily has any relevance to what in fact constitutes compensation.

Q. So whatever the Bar might tell its members, or indeed whatever the members might tell the Bar would have no relevance to your views on compensation?

A. In this case, that is correct.

Q. And if they held a meeting every year to which every lawyer came, where the entire purpose of the program was explained, and if an opportunity were given at that meeting to change the purpose of the program, and when the opportunity was presented every member of the American Bar Endowment got up and walked out, you couldn't care less in terms of your opinion on compensation in this program; is that correct?

A. Yes, that is correct, because I don't think that changes the facts relating to what retention of those dividends amounts to.

Q. Mr. Barnhart, what do you know about the facts in terms of the relationship of the American Bar Endowment to its members? You made no attempt to find that out, have you?

A. Oh, I think I have. I have read quite a few [2620] documents and reports, memoranda, quite a bit of information on that.

Q. Did you read the testimony of Mr. Reece Smith?

A. I have not.

Q. You have no idea what he testified to, do you?

A. No, sir.

Q. You have no idea about how the American Bar Endowment is governed, do you?

A. No, I don't.

Q. And you have no idea about how issues are raised at the American Bar Endowment meetings, do you?

A. No.

Q. And you couldn't know less about their procedures, could you?

A. No.

Q. And you have no idea whether in fact for all you know the subject of the insurance program could have come up every year for a vote, isn't that right?

A. It would be possible. I wouldn't know whether it had or not.

Q. And you just don't care what each side told each other in this insurance relationship; is that correct?

[2621] A. Well, I wouldn't say I don't care. But I wouldn't consider it relevant to my judgment as to the nature of the retention of the dividends by the Bar Endowment.

Q. You think you might have been able to make an opinion as to relevancy to your judgment on a better informed basis if you had made an effort to find out?

A. No, I really don't, because I don't believe I could have learned anything that would have made any change in my opinion. I think it would be very, very unlikely that that could be true.

Q. I think you are right.

Mr. Barnhart, we went over the four associations that you list on your resume in terms of providing advice and their association group plans. They are all big; is that right?

A. Yes. The American Optometric Association is perhaps the smallest, about 20,000 members. But the others are all quite large associations. Well, no, excuse me. The orthodontists would be the smallest, they have about 9,000 members.

Q. And these associations are in a position on behalf of their members to negotiate favorable terms and conditions with insurance companies?

[2622] A. Well, I wouldn't say the orthodontists or optometrists are really in that position. Because in obtaining the bids we found out that they didn't appear to be as attractive as we had supposed. We didn't get as many bids as we would have liked.

Q. What about the American Medical Association and the psychiatrists?

A. I think both of those would be considered very attractive association cases by most companies.

Q. Attractive associations that for various reasons could end up commanding low net cost for the benefit of their members; is that correct?

A. Particularly the American Medical Association, which has about I think 240,000 members, yes. It is mainly a matter of size. Size and prestige. Those two factors tend to predominate in the thinking of the carriers as to how much they would like to have the organization insured with them.

Q. How about the third-party administrators? Are they interested in organizations of size and prestige?

A. Yes, I think equally so. Yes.

* * * * *

[2627] Q. Well, there is certainly no doubt in your mind that the ABE rates are an overcharge compared to what this association could negotiate if they, if the association, determined to run a service insurance plan for members; is that correct?

A. The association could at least on the three programs generating larger dividends, could be charging lower premiums.

Q. Tell me what the cumulative percentage dividends has been on the accidental death dismemberment—ADD-250 program for ABE?

A. I couldn't give you the cumulative. In percentage form?

Q. Yes.

A. I couldn't give you the cumulative, though I would judge it to be probably in the area of 40-50 percent. But I could not give you that.

Q. Cumulative dividend is 40 to 50 percent? Do you know what the dividend was last year?

A. 1982?

Q. Yes, sir.

A. No, sir.

[2628] Q. Well, there is testimony in the record that it was 53 percent. Do you know what the estimated dividend is this year?

A. I do not.

Q. There is testimony in the record that it is in the 90 percentile.

A. It is a dividend that will fluctuate dramatically from year to year because three or four claims would equal the annual premium income. One of the years in suit here I think there were no claims. The loss ratio was virtually nil. So the experience can range all the way from no claims to several, and three or four claims would wipe out the premium on that program.

Q. As an actuary would you agree with my suggestion that it is a volatile program?

A. Indeed I would, yes.

Q. As a violatile program doesn't it make more sense to look at the return on that program over a period of time longer than one year?

A. Oh, yes. Absolutely.

Q. So you would agree with me that with an experience to date through 1981 of 40 percent and 53 percent in 1982 and 90 percent or so in 1983, there has indeed been a substantial return on that program?

[2629] A. Over that period, yes. Again I would say three years is too short. You would want to look at that program over about 15 years.

Q. So far the program—I believe the program started in 1976, so it is in existence for maybe seven years?

A. Yes.

Q. What about the major medical, do you know what the cumulative return has been there?

A. No, sir. Not on the cumulative basis. But I would guesstimate at perhaps 20 percent.

Q. You didn't make any effort to determine that in terms of expressing your opinions in this case, did you?

A. No, I looked at the experience over the three years in suit here.

Q. And didn't look at it before then or after then?

A. I saw the results for the period before then. And during the first four or five years it generated pretty substantial dividends in the early—first three or four years it was in force.

Q. In the preparation of Exhibit 1336, did anybody tell you what companies to include or what not to include?

[2646] * * * * *

A. In general. But it is impossible to know the rates and the exact position of every one of hundreds of companies.

Q. Do you make it your business to know the lowest rate companies?

A. To be aware of some of the low rate competitive companies, of which Occidental Life has always been a notable example.

Q. You don't know Kemperer's position?

A. Not specifically, no.

Q. Let me direct your attention specifically to the exhibits. Do you use male rates only for convenience?

A. Not for convenience. But because male rates would generally be the appropriate rates to compare. Most of the members would be males.

Q. What percentage of the members of the American Bar Endowment are males?

A. I don't know exactly. But I would expect it certainly must exceed 80 percent. In most professional societies it is over 90 percent.

Q. You don't know what the bar is?

A. I don't know the specific demographics.

Q. Last five years, do you know how many people [2647] graduating from law school were women?

A. No, sir, I don't.

Q. Is it fair to say irrespective of how many members of the bar are women, that Exhibit 1 here doesn't fairly reflect what women could get life insurance at?

A. That is correct, it does not really show women's costs.

Q. What are the standard rates? Why did you pick standard?

A. Standard because those I think would be the best representative rates for most of the members, for the majority of the ABA members.

Q. I noted that you footnote the fact ABE accepts applicants up to 250 percent of New York Life's standard mortality. Why did you do that?

A. That is to point out the fact that ABA members can get into the Bar Endowment program at a substandard

level at which they could not get into most of these other standard plans on the market.

In other words, the ABE underwriting is more liberal in that respect, and which adds to its value.

Q. New York Life's underwriting is more liberal?

A. New York Life's, yes.

Q. All right. Am I not correct that [2648] approximately 90 percent of the life insurance that is underwritten in this country is issued standard?

A. I would say 80 to 90. I am not sure as high as 90.

Q. Am I not correct that approximately 5 percent of the people in the country are uninsurable, at least in the eyes of the insurance industry?

A. That is a pretty reasonable estimate, yes.

Q. And then taking either your percentage or mine, 5-10 percent maybe are rated; is that correct?

A. My experience has been that probably around 10, between 10 and 15 percent get rated on some basis.

Q. What percentage of the population is eligible for preferred rates?

A. I wouldn't be sure about that, but I would judge it is probably in the area of 20 percent maybe.

Q. Okay, so we have 20 percent of the population eligible for preferred rates, something less than that gaining the benefit, as I understand your testimony, of the New York Life underwriting, but your exhibit refers only to the fact that some people who are on standard can get into the ABE plan, it doesn't say a word about the fact that maybe 20 percent or more of the lawyers would be eligible for rates cheaper than standard rate? Isn't that fair?

[2649] A. Well, that is fair, but you also have the proportion going the other way. I think the appropriate comparison is to use standard rates here, that would cover the majority.

Q. My only point and maybe it is not that much of a point is that you footnote it one way and didn't footnote the other way.

Let me direct your attention specifically to the American Bar Endowment column and the 50 and over figure, $1375. Am I not correct that the rate for a lawyer 55 to 59 if you had bothered to interpolate out would be $1833, not 1375?

A. Yes, it would continue to rise on a per $100,000 basis.

Q. You didn't bother putting that on this table?

A. No, I didn't think that was that pertinent. This was not meant to be a precise analysis but only to place the general competitive position of the bar program. It is not necessary to be completely precise and detailed in order to establish a general competitive comparison.

Q. And it was not necessary to put in the higher rate, right?

A. Not necessary to put in rates at higher ages.

Q. Let me see if I understand something about [2650] waiver of premium and accidental death dismemberment.

Do I read your footnotes correctly to say that the plans other than ABE don't contain those provisions or benefits but you made mathematical or dollar adjustments to include them?

A. Are you referring to Exhibit 1 still?

Q. Yes, Exhibit 1.

A. WP and AD can be purchased with those plans. The rates shown in the Life Rates and Data addition show the rate for just the basic life but WP and AD can be purchased.

Q. And you adjusted those plans to include those benefits?

A. To include those benefits, yes.

Q. Let me ask you about the New York Life column. What dividends was [*sic*] illustrated on the policy referred to in that column?

A. I don't recall, Mr. Gregory. It wouldn't be simply a dividend, but rather a net cost projection, probably a 20 year net cost projection.

Q. Am I not correct there was indeed a net cost projection illustrated and that illustration is is [*sic*] not reflected on this table?

A. That illustration is not reflected here, that is correct.

[2651] Q. Am I not correct that in 1980 the New York rates for term life were in fact behind the rest of the industry, behind in the sense of not as low as the rest of the industry?

A. I don't know about that, whether they would really be judged as behind or even or just where. It is a very fluid business, of course, as to who is lowering rates or adjusting rates first and second and third and I don't know where I would try to put New York Life in that spectrum.

Q. Do you know what happened to the New York Life rates in 1981, 1982, 1983?

A. I believe they have been reduced.

Q. About 40 percent?

A. I don't know the magnitude, but I am quite sure they have been reduced.

Q. Let me make sure I understand one other thing. I am referring to the columns other than ABE on Exhibit 1. Am I not correct that what is illustrated is annual renewable term insurance at guaranteed rates?

A. All of these non-participating programs are at guaranteed rates, yes. Also the New York Life rates on a gross basis are guaranteed.

Q. And the bar plan's rates are not; is that [2652] correct?

A. The bar plan's rates are not guaranteed.

Q. Let me ask you to turn to Exhibit 2. Do I understand your criteria of selection to be large states with large members of the bar?

A. Yes, along with the fact of finding other associations that wrote amounts of insurance up to the general

level of what was available under the bar. And plans that were reasonably comparable in that sense as well as larger states.

Q. We established this morning you did not include California because you didn't have the information available and did not bother to get it; is that correct?

A. That is correct.

Q. Were you here for the testimony of Ms. Khachadour?

A. No, Sir, I was not.

Q. Do you know the Government brought her from California to testify?

A. I did know that.

Q. Do you know she testified about the California State Bar insurance plan?

A. I don't know what she testified about. I didn't hear it.

[2653] Q. Why didn't you include the Michigan Bar?

A. I don't recall exactly, Mr. Gregory. I looked at the Michigan Bar and I at the moment can't recall why I felt it was not a good example to include. There was something about that program that didn't seem as though it made a ready comparison but I don't recall what it was.

Q. Rather a large state with a lot of lawyers?

A. It is a pretty large state, yes.

Q. So is New Jersey, isn't it?

A. Yes.

Q. So is Illinois, isn't it?

A. Yes. These are here as illustrations, Mr. Gregory. My conclusion or opinion doesn't simply depend on this analysis. This is illustrative.

Q. We will get to your conclusion.

A. All right.

Q. And Florida doesn't appear, does it?

A. No, sir.

Q. And the L. A. County Bar doesn't appear, does it?

A. No. I didn't try to use any city or county bar plans; just used state bar plans.

Q. Do you know if there are more lawyers in Oklahoma or Los Angeles County?

[2654] A. I expect more in Los Angeles County.

Q. Didn't use the District of Columbia bar, did you?

A. No, I did not.

Q. We can all agree there are too many lawyers in Washington, right?

A. (No response)

Q. I don't see the Pennsylvania bar around. It is not on either?

A. No, not here.

Q. And you did not pick the Missouri bar, your home state?

A. No.

Q. And there has been testimony in this case about the Missouri bar plan, are you aware?

A. Yes, I am aware. I heard Mr. Gardner testify about that.

Q. And you were here when he testified about the Missouri bar?

A. Yes.

Q. And about dividends going back to the members?

A. Yes.

Q. Low net cost insurance?

A. Yes.

[2655] Q. Directing your attention to column 1 again on ABE, – in fact let me see if I understand what is going on here. What is the 55 to 59 in the second column right under where it says exhibit?

A. That is the age bracket.

Q. And across this column you are illustrating rates for age 55 to 59?

A. Yes, showing the rate up to that point.

Q. But not for the ABE?

A. No, the benefits begin to grade at age 55.

Q. And you did not determine what the cost per thousand was at age 55 through 59 which is $1833, did you?

A. No, I did not.

Q. Let me ask you to look at the Georgia Bar column. If you had put in the 55 to 59 age, am I not correct that the net dollar cost for the Georgia Bar was less than the gross premium charged by the ABE at every age?

A. Less than the gross premium charged for the ABE at every age? The net cost you say for 55-59?

Q. No, the net cost for each age for the Georgia Bar. Is it not correct that that net cost is lower than the gross premium cost at the ABE for every age, assuming you had bothered to put in the 55 to 59 [2656] figures for the ABE?

A. I believe that would probably be true. I would have to check the costs – you mean comparing to the gross ABE premium?

Q. Why don't we just take an example. Perhaps I am not being clear. Under 30, ABE gross premium, $200, right?

A. You are referring to the ABE gross premium then?

Q. That is correct.

A. That is the clarification I was asking.

Q. And am I not correct that the appropriate comparison for the Georgia Bar is 132?

A. Yes. Yes.

Q. Well, my question – and looking at the exhibit, if you have not determined it already – I am asking you am I not correct if you made a similar comparison at each age the Georgia Bar is materially cheaper?

A. It would be lower.

Q. And if the ABE is in the bottom third of rates how far down would you look to find the Georgia Bar?

A. I would say it is probably in the lower 20 percent.

[2657] Q. What is the universe of one that you are comparing these rates to in terms of lower one-third? Lower one-third of what?

A. The totality of the types of insurance represented on the three exhibits. In other words, state bar plans, individual term rates, mass-marketed, credit card; all of the range of competitive products that are in this marketplace available to attorneys.

Q. How does the ABE insurance compare under that standard on Exhibit 2? That is, ABE versus state bars?

A. Here it would compare a little above 50 percent. It would be in the upper half.

Q. Well, it certainly is above Georgia at every age level; is that correct?

A. That is correct.

Q. Let's take a look at Massachusetts. What does bonus mean at the top of that column?

A. In 1981 they declared a dividend in the form of an additional 50 percent, I believe it was an additional 50 percent over the regular amount but available at the regular rate. And this takes account of that, this reduces the rate per hundred thousand based on the bonus amount of coverage available.

In other words, they would have gotten [2658] $150,000 of insurance at the same rate as they would have paid for a hundred thousand, and this recalculates the rate per hundred thousand on that basis.

Q. What refunds—excuse me, what are refunds done—strike that, please.

Should this be NEBA, by the way?

A. It should be NEBA.

Q. That is a trust?

A. Yes.

Q. What does the trust do with the refunds that are assigned to it?

A. I do not know.

Q. And you don't know whether it goes back to the members or not, do you?

A. I have not examined what the trust itself does with those refunds.

Q. So if indeed it does go back to the members that is not reflected in your calculations?

A. Not to the extent there might be any additional cash dividends paid. The bonus itself is in the nature of refund. This is one way of providing a refund is to give a bonus in coverage as distinguished from a reduction in premium.

Q. Did you determine in the course of your [2659] analysis how the Massachusetts rates compared at various ages with ABE?

A. As far as the chart is carried, yes, to the end of the low 50s.

Q. At what rates is the—what age is the bar higher, what age is the bar lower than Massachusetts?

A. The bar rates become lower at age 35, and I believe remain lower above age—starting with age 35.

Q. Let's take a look at Minnesota. I am looking now at the bottom of the first column. That indicates substantial dividends on the first 80,000 of insurance, is that not correct?

A. Yes, it does.

Q. That is not reflected in your rates, is it?

A. No, because I only actually reflected in that, rates under these calculations where the amount is definite. Where it is clearly determinable.

Q. Wait a minute. 49 percent of something was determined in 1977, wasn't it?

A. In 1977, yes.

Q. And 1978 was 56 percent?

A. That is correct.

Q. And 1979 was 60 percent?

A. Well, but those were after the fact. Those are determinations after the fact. I brought in net [2660] cost calculations here wherever that is known to the member at the time he would buy the coverage. That was the criterion followed here.

Q. You think the Minnesota Bar told people that they received these significant dividends?

A. I am sure they did.

Q. And you certainly are sure that it impacted their store of knowledge about that program, aren't you?

A. Yes, I would certainly expect so.

Q. And if you had put anything for dividends in the calculations for the Minnesota Bar, those bar rates would have been lower at all ages by far than ABE?

A. They would have been lower, yes.

Q. Let's look at Texas. Do you know what happened in 1981, in Texas, with the Texas Bar?

A. No, sir, I don't.

Q. Am I not correct that the Texas Bar rates illustrated are lower at every age than the American Bar Association rates?

A. Yes, they are.

Q. You have no idea how the Texas Bar handled its insurance situation in 1981?

A. No, sir, I don't.

[2661] Q. Who underwrites the Texas Bar?

A. At this time it would have been Prudential Insurance. These are Prudential rates.

Q. And Prudential Insurance began underwriting in 1981; is that correct?

A. I believe that is correct, but I was not certain about that.

Q. Let's take a look at the Indiana Bar. On your illustrations, am I not correct that the Indiana Bar provides lower insurance to members than the ABE at all ages except age 55?

A. Yes, I believe that would be correct.

Q. And if you had done the calculations for ABE at 55 it would have been within a hundred dollars?

A. Would have been close, yes.

Q. How did you account for the experience premium reductions in Indiana in computing your rates?

A. I did not take them into account because I had no information on what those might have been.

Q. Did you bother calling the Indiana Bar to find out?

A. No, sir, I did not.

Q. Don't you think you should have?

Q. No, sir. As I mentioned, these are illustrations here. All we are talking about is a [2662] spectrum of broad price competition, competitive rates over a marketplace spectrum. And the kind of precision you are suggesting is needed here is simply not necessary to this kind of analysis.

Q. Let's look at the Indiana Bar. Why don't we just pick age 45 to 49. 632.00. Is that a broad spectrum, a broad range or is that a precise figure?

A. That is a precise example.

Q. And if you had call the Indiana Bar with respect to 1981, you could well have found out the actual net cost to the member was lower than that, right?

A. Probably so, yes.

Q. But you did not bother?

A. No, sir.

Q. Let's turn to New York. What did you do with the accidental death and ADD-250, or ADD portion of the New York State Bar; how did you compute that?

A. That has been added into the rate at the $72 per hundred thousand basis.

Q. And how did you account for that in adjusting the dividend?

A. That is not accounted for because the dividend was 45 percent of the life premium. There has been no adjustment made here up or down for the [2663] accidental death.

Q. Is it not a fact, sir, that you added the $72 to the New York rate and took no account of the fact that a substantial dividend increase would have occurred, if accidental death had been included in this particular plan?

A. It would not necessarily have been the case at all. They might or might not have any dividend.

Q. What was the cost of the American Bar Association accidental death components in the New York Life Insurance plan?

A. Which year?

Q. How about the year you were dealing with, 1980-1981?

A. 1981? In 1981 they had a—that was a year of a very large refund, about 97 percent. In 1980, it was zero.

Q. I am talking about the New York Life Insurance plan, Mr. Barnhart. I think that is what Exhibit 2 is about.

A. I thought you were talking about the accidental death.

Q. The accidental death component, yes. It is my understanding you are testifying that you put the component into the New York Life rates, upped the [2664] rates at $72 for the New York State Bar; is that correct?

A. That is correct.

Q. And I am asking you, sir, is it not a fact that New York Life would have paid a dividend on that amount in 1981 if the full $72 were not needed?

A. If the $72 were not needed, yes.

Q. Is it not a fact, sir, that the experience on the ADD, was that the cost for the disability component—excuse me, I misspoke. The accidental death components was between 30 and $32, not $72?

A. On what basis?

Q. On actual experience basis on the American Bar Endowment plan at New York Life, in the 1980-1981 timeframe?

A. But not to the member, Mr. Gregory. Only to the Bar Endowment as group policyholder, not to the member.

Q. That is fine, New York State Bar people get the dividends back, isn't that correct, sir?

A. Yes, but we don't know, have no way of knowing what their dividend might have been had they included accidental death in this plan.

Q. Are you suggesting that if accidental death was included in this plan, the cost would have been [2665] closer to $72 than to the 30 to $32 experienced by the American Bar Association?

A. It might have been every nickel of the $72 or it might have been 30 or 40 or 50.

Q. Or it might have been 20, 25 or 30?

A. Might have been 20, 25 or 30.

Q. And it is a participating plan; is that correct?

A. That is correct.

Q. And the money goes back to the members?

A. Yes.

Q. And you have been comparing New York State Bar to the ABE which has had a cost of 30 to $32, not 72, and your rates on the New York State Bar column make no adjustment for the possibility of a dividend, correct?

A. No dividend on the accidental death.

Q. You just put it in at 72 and assumed there would be no dividend; is that correct?

A. I didn't assume anything about it, about a dividend. Simply that this was not a known quantity.

Q. And not one you made any effort to get any information on either?

A. Well, they didn't write it; there wouldn't have been any way to get information on it if they [2666] didn't write it.

Q. What about Ohio, how did you account for the dividend in the Ohio plan?

A. There again, because I had no information on what the dividend experience was, there is no account taken of any dividend.

Q. And again, you made no effort to get the information?

A. That is correct.

Q. Now I am correct on the New York column, the net column, that even with your method of putting in the gross only for the accidental component and not giving credit for dividend, that the New York bar plan is lower at every age?

A. Yes.

Q. And even without factoring in the dividend on the Ohio plan, it is lower at all ages but two?

A. Yes, sir, that is correct.

Q. How does Oklahoma get into this? How many lawyers are there in Oklahoma?

A. I don't know, but Oklahoma is one of the more substantial states.

Q. Mr. Barnhart, isn't it a fact that what Exhibit 2 demonstrates, based upon the companies that you have chosen, is that there was available in the [2667] years you have chosen to members of the American Bar Endowment substantially cheaper insurance from their state bar associations?

A. In many instances, yes.

Q. And the numbers are right here, correct, on Exhibit 2?

A. Yes.

Q. Except for the ones you did not bother to get.

A. (No response)

Q. Why didn't you include the L. A. County Bar?

A. As I mentioned, I was only using state bar plans. I did not really consider using any city or county bar subdivisions.

Q. You were given the brochures for L. A. County Bar by the Department of Justice, were you not?

A. I don't recall that particular one. I had the Philadelphia Bar and the D.C. Bar. I frankly don't recall seeing the L. A. County Bar. But I had a lot of them, so I might have had.

Q. Let me show you, it is marked as Defendant's Exhibit 2090.

THE COURT: Have we seen this one before, Mr. Gregory?

MR. GREGORY: No, I won't ask that it be [2668] introduced, but we have not seen this before. This was marked by Defendants who asked us to enter into a stipulation, I think, or something.

BY MR. GREGORY:

Q. I guess my first question has to be did the Department of Justice provide you with the L. A. Bar brochure?

A. I am honestly not sure. I don't recall seeing it, but there were so many there that it could well have been included.

Q. This is underwritten by Northwestern National; is that correct?

A. Yes, it is.

Q. And they underwrite a lot of bar plans, am I not correct?

A. I don't know about bar plans, but they are certainly active in the association group field.

Q. You will agree they are quite active in the association group field?

A. Yes, sir, they are.

Q. It is administered by Marsh & McClennen, a leading third-party administrator with whom you have dealt yourself; is that correct?

A. That is correct.

Q. My reading of the brochure, and I assure you [2669] it may be faulty so take the time you want, is that the plan includes accidental death and dismemberment as

well as waiver of premium. I believe that any dividends are credited to the participants.

All I want you to do is look at it, and see if you would not agree with my observation that the rates available to members of the L. A. County Bar are substantially less than the rates provided on your Exhibit 2 for the American Bar Association?

MR. DENNIS: Your Honor, I would just like to ask that the witness be given five minutes to review the document, five to ten minutes, because he has advised me it takes quite a bit of time to look through a brochure and determine whether it is comparable to the Endowment plan. So if we are going to be having the witness review a lot of state bar plans, perhaps counsel could give them to the witness so he could take time to review them rather than trying to rush him through his testimony.

MR. GREGORY: Let's put aside the suggestion, which I know was not intended, that I try to rush anybody through testimony. I have just three other brochures and just a few questions about them and I would be happy to give them to the witness.

Your Honor, yes, I think that is a good [2670] suggestion, we might take five minutes and enable me to finish quickly.

THE COURT: Well, I am at the mercy of counsel. I don't know how long it takes to review these things. If counsel tells me and the witness tells me, we will take the break. Do you think that would help you, Mr. Barnhart?

THE WITNESS: Well, I believe in this instance I have looked at it far enough to answer Mr. Gregory's questions on the life program, I believe.

MR. DENNIS: Fine.

THE COURT: Don't feel rushed.

THE WITNESS: It was all here, right here pretty readily locatable.

THE COURT: I remember L. A. County is pretty snappy in its brochures. If any time you have a problem in answering a question, just be sure to ask for more time.

THE WITNESS: I believe I can respond. Would you state the question you had on this, Mr. Gregory?

BY MR. GREGORY:

Q. Well, I will do better than that. I will put us out on a limb. Here is what I think the differences are; you tell me if I am right or wrong [2671] and then we will take talk about it.

(Document handed to witness by Counsel Gregory.)

THE COURT: You have been using your calculator again, Mr. Gregory?

MR. GREGORY: No, I have been using Ms. Carpenter again.

THE COURT: I know she offered me a calculator the other day. Completely lost my composure.

MR. GREGORY: There are a thousand things you want to keep me away from. One would be exhibits and the second would be math and calculators.

MS. CARPENTER: Would you like a calculator, Mr. Barnhart?

THE WITNESS: No, I am just multiplying by two in this case.

THE WITNESS: Your figures are correct, Mr. Gregory.

MR. GREGORY: We have a very erudite actuarial presentation, it says "us, them and difference." At ages 30 to 34, us is 250.

THE COURT: "Us" I take it is—

MR. GREGORY: American Bar Association. The good guys.

[2672] THE WITNESS: And I understand them to be Los Angeles County.

MR. GREGORY: 189 for L. A. for a difference of $61. Ages 35 to 39, us $375. L. A. County 252 for a difference of 123.

Ages 40 to 44, the Endowment, $500. L. A. County 370. For a difference of 130.

45 to 49, L. A. County, $875—excuse me, the bar $875, and L. A. County 552, for a difference of 323.

And ages 50 to 54, American Bar Association $1375, L. A. County $955, for a difference of $420.

I think you could agree that the L. A. County Bar rates are lower at every age?

THE WITNESS: Yes, sir, they are.

BY MR. GREGORY:

Q. Substantially?

A. They are substantially lower, yes.

Q. Why did you not include the South Carolina Bar?

A. I might have passed them up as being a smaller state, again. I passed up a lot of states on the basis of being relatively low population states.

Q. South Carolina smaller than Oklahoma?

A. I think so, yes.

[2673] Q. In terms of lawyers?

A. I don't know. I was going just by state populations. I was assuming the ratio of lawyers to population is roughly—

Q. Dangerous assumption in D.C.

THE COURT: Or L. A. County.

MR. GREGORY: Or New York City.

(Document handed to witness by Counsel Gregory.)

BY MR. GREGORY:

Q. Now, this bar as well, and I will give you all the time you want, let me tell you my assumptions first. It is administered by Northwestern National again. It has guaranteed rates, accidental death and waiver of premium are included. The bar member can elect to purchase up to $500,000 in insurance.

Now, I would like you to take an eye look at the rates, please? My only question is whether I am correct that the rates are lower at all ages for the members of the South Carolina Bar than for the American Bar Endowment.

MR. GREGORY: Let me say this is labeled Defendant't Exhibit 2087.

(The document referred to was marked Defendant's Exhibit No. 2087 for [2674] identification.)

THE WITNESS: Yes, sir, these again would be lower at all the age brackets.

BY MR. GREGORY:

Q. I think I can skip the couple more exhibits I had for you.

Am I not correct that if I took the time to do it, I could go on out and check the state bars and based upon your Exhibit 2 and other material furnished to you by the Department of Justice, isn't it absolutely correct that members of state bar associations had available to them insurance at rates substantially cheaper than offered to the American Bar Endowment?

A. Certainly not in every instance. Some—well, many states, yes, but not in every instance.

Q. The ones that you put on your chart and the ones I have shown you today?

A. Among these, by and large, yes.

Q. The numbers will speak for themselves on the chart, correct? Or the generalities would speak for themselves on the chart; is that right?

A. What generalities, sir?

Q. (No response)

Let's move on quickly and try to finish this. [2675] Take a look at your Exhibit 3, please. You state in your testimony here, sir, that the bias in your work was in favor of the American Bar Association because standard rates were used. That is just not correct, is it?

Based upon our discussion before, is it not correct that the bias is against the Endowment because it is more logical to expect that more ABE members are eligible for preferred rates than would have been underwritten adversely?

A. Well, more of them would have been eligible for preferred rates, but when an individual has to take a substandard rate the difference will generally be higher the other way. In other words, a smaller number of people rated substandard will account for more dollars of difference. I don't think you can properly assume that simply because more people will get preferred than get substandard, that the dollar effect of that is therefore in favor of the preferred.

Q. Were the policies on Exhibit 3 sold with waiver of premium and accidental death benefits?

A. By and large, these had a waiver of premium included. But the accidental death I added in again to make the rates equivalent.

Q. To the extent you added in the accidental [2676] death, then the policies illustrated on Exhibit 3 don't exist in the marketplace; is that correct?

A. In that sense they would not, that is correct.

Q. What percentage of individuals in the United States today qualify for non-smoker rates?

A. Among companies that offer that rate, which is an increasing number, it tends to run 60 to 70 percent qualify for the non-smoker discount.

Q. A lot more than get rated, right?

A. Yes, that is true. But again the percentage difference is much smaller. The tendency is for non-smoker discounts to run five or 10 percent most of the time.

Q. Let's look at Exhibit 4. Was this Exhibit completed on October 6, 1983?

A. I believe so. Yes.

Q. Do you have any idea why we didn't get it?

A. No, sir, I don't.

Q. This illustrates catastrophe major medical; is that correct?

A. Yes, or excess major medical as it is sometimes called.

Q. Do I see two question marks under the ABE column on this exhibit?

[2677] A. Yes, the years, which I verified after testifying yesterday, those are correct. Those were the rates in effect in that year, in the year 1977 and also in the year 1979.

Q. How does your chart give effect to the rate increases in 1979 and 1980 for the major medical plan of ABE?

A. These show the rate increase that took effect in 1979. And that is that increased rate.

Q. I see here in the other columns Georgia, '82, Minnesota '80, Illinois '80, Indiana '80, Ohio '81 and Virginia '81; is that correct?

A. That is correct. Yes, sir.

Q. And under ABE, you did not take into account any increase in 1981, did you?

A. No, sir, I didn't carry it that far. There was an increase, I believe, in September of 1980. And an increase in 1981 also.

Q. Just quickly on Exhibit 5, am I correct that the column for the New York Bar does not illustrate a 28 percent reduction for the experience rating?

A. No, sir, those are the gross rates.

Q. So I am correct that it does not illustrate the experience rating?

A. That is correct, it only notes that it was [2678] averaging about 28 percent at that time.

Q. Do you find it customary in the group insurance business to talk about expected loss ratios in a range of 70 percent?

A. Yes, sir, particularly association group. That is a pretty normal or pretty customary expected loss ratio for rates to be established at.

Q. Was that before or after retrospective credits?

A. That is before. That is a gross rate determination.

Q. Well, I am finished with this exhibit. Now just a couple more areas and we will be done.

I want to turn to the subject of risk, Mr. Barnhart. As a participating policyholder of the Northwestern Mutual Life, do I bear an insurance risk?

A. Only a very slight and remote risk as an individual, because you would be pooled with tens or scores of thousands of other persons. You would have a very small share of that.

Q. And each of the individuals in my class, and that is what we refer to as pooling for purposes of distribution of divisible surplus, my class?

A. Yes, determined on a class basis.

* * * * *

[2681] Q. You tell me why it doesn't?

A. Well, the Bar Endowment is subject to the aggregate risk of its particular membership. So any fluctuations that occur, immediately impact directly on the bar. Now, to the extent each member would get a pro rata share of this, is that were those dividends returned, then each member would bear the same—his same small percentage share in that proportion. But the member does not have expenses, for example. He doesn't have any expenses at risk in the sense of the Bar Endowment must also cover its expenses.

Q. I thought we were talking about insurance risk. We will get to insurance expenses. You testified yesterday, if I understood you, that the Endowment functions as an insuror and that New York Life is a reinsurer because it is a participating policy and the dividends might be reduced to zero. And I am suggesting to you that that is no different than any other large professional association such as the ones you represent who return the dividends to the members; no different in terms of the mortality-morbidity risk. Is that fair?

A. Yes, that would be true in the aggregate. Yes.

Q. So then the people you represent function as [2682] insurance companies?

A. You mean the association groups I work with? Not the association.

Q. Yes; have you told them they are insurance companies and that Mutual of New York or New England Mutual is a reinsurer?

A. Well, the dividends there take the form of renewal premium reduction to the members so the dividend gets passed on to the individual member. You could look at each member as bearing his tiny share of that risk.

Q. As a tiny little insurance company?

A. In a sense he is self-insuring a small portion of that total risk, yes.

Q. Have you ever told any one of the associations you represent, or any one of the tens of hundreds of those members of those associations, that any one of them or all of them has functioned as an insurance company?

A. No, not on the individual basis.

Q. Have you ever told any one of them that they are not involved in a group insurance program?

A. No, I don't believe I have ever said they are not involved.

Q. But you say the Endowment is not group [2683] insurance, it is individual insurance?

A. Yes. That is correct.

Q. Have you advised the members of your association to strike the phrase group insurance from their brochures?

A. No.

Q. Have you told them not to represent to the members that these are group insurance rates?

A. No. These are group insurance rates. The rates are a group rate.

Q. Oh, well yesterday you said the benefits were similar to group insurance, and now today we can agree that the rates are group insurance rates? Is that correct?

A. Yes, the rates are group rates.

Q. And I am sure now we can also agree that the existence of the experience refund or the dividend is more akin to the group insurance, as you understand it, than it is to individual insurance?

A. Oh, yes, which I testified to yesterday. The dividend, itself, is a group type experience rating.

Q. Well, today we can agree then at least as to the comparison between group and individual that the Endowment can be compared to group as to rates, [2684] benefits, and experience refunds, correct?

A. Yes.

Q. Just like all the other associations you represent. Mr. Barnhart, you have never told anybody, suggested or testified that association group insurance is not group before your testimony in this case, isn't that correct?

A. Because that distinction, Mr. Gregory, was not pertinent in those cases. Here the question of whether the insurance involved is more like individual or more like group would appear to be a relevant question. There I don't think it is a relevant question.

Q. Can you cite me one example of a professional association group, a legitimate association that you know of that receives and retains dividends of the size of the Endowment?

A. I would not know of any receiving dividends in that magnitude, no.

Q. And certainly none of your associations do? The ones that you advise?

A. You mean in which the association retains the dividends?

Q. Yes.

A. No, none of them do, they all pass it on [2685] through in premium renewal discounts to the members.

Q. Did I understand you to testify yesterday that the Endowment had a—something about significant share of the market.

A. Yes.

Q. What were you saying?

A. I was saying a share of its market. Its market is the membership of the American Bar Endowment. And, for example, under the life program there are about 40 thousand, roughly 40 thousand members insured, which is approximately I believe 20 percent of the membership. I believe the ABA membership is about 200 thousand.

Q. In what year was the ABI membership 200 thousand?

A. I would have estimated it at that, at about this time, around 1979 or 1980.

Q. What is the basis for your estimate?

A. I think it was some of the numbers I looked at in that Moran study, the New York Life study.

Q. You didn't read any testimony from ABA representatives?

A. I don't believe so, no. No.

* * * * *

[2689] Q. So what you are telling me is that the members of the American Bar Association who have been elected by their peers as officers identified themselves as a good submarket upon which to profit at their own expense?

A. I am not suggesting some deliberate selecting of a market but only that this is the submarket that they in fact deal with.

Q. Did I hear your testimony incorrectly yesterday, did you not say yesterday that they identified a good submarket?

A. Yes, I used that term.

Q. Would you explain to me where the profit on the American Bar Association Plan comes from?

A. The profit basically comes from the favorable mortality and morbidity exhibited by the membership.

Q. "Favorable mortality and morbidity exhibited by the membership."

A. That is correct. And that in relation to the price that is being charged for the program.

Q. And who sets the price?

A. The price would be negotiated between the Bar Endowment representatives and the insurers.

Q. And the Bar Endowment representatives are [2690] the elected members of the Endowment? Are elected by the members of the Endowment?

A. I presume that they are, I don't know just how those officers are selected.

Q. What services does the Endowment perform from which they generate the five to seven million dollars of profit alleged in this case each year?

A. Well, they first perform the service of negotiating a program to be available to their members, making that program available to the insurers. I think this is a significant function that they perform, making a market, a special market available to the insured. They market the program, prepare the literature, market the program, solicit enrollment, receive and process applications, do a certain amount of preliminary underwriting or prescreening on those applications, they bill and collect the premiums, receive the premiums, remit them to the carrier.

They also, as I understand it, receive the claim reports and do a certain amount of preliminary screening of claims mainly just to see that the claim report is complete. And at that point the claims are transmitted onto the insurers for actual payment.

Q. What service have you identified to me in that recitation that is not performed by each and [2691] every association you represent either singularly or in concert with a third-party administrator?

A. I believe the association and the third-party administrator in combination in all the ones I work with would perform pretty much that same range of services.

Q. And you can't identify for me another professional association in the United States that makes profit to the extent of the Endowment from performing these services, can you?

A. Not to that extent, no.

Q. Ms. Khachadour, formerly of the California Insurance Department, said that the level of profits made by the Endowment would make her choke.

As an advisor to professional associations and their members wouldn't you choke if an association were profiting to the extent – profiting to the extent of 50 percent of premiums on its own members?

A. I would certainly not be very happy about that.

Q. And you certainly wouldn't be happy if you were a member, would you?

A. No, I would not.

Q. You would do whatever you could to get your association to change that horrible state of affairs, [2692] wouldn't you?

MR. DENNIS: Your Honor, he is not testifying as a member of the association, he is testifying as an expert actuary in this case.

BY MR. GREGORY:

Q. You are a fellow in the Society of Actuaries?

A. Yes.

Q. As president – you were president of the Society of Actuaries, am I correct?

A. Yes, I was.

Q. Would you have even dreamed of profiting on the members of the association on an insurance program to 50 percent of premium?

A. It wasn't a matter that entered my thinking at all, Mr. Gregory, because the society being what it is you would never get the members to agree on an insuror for an association plan. It just wasn't a matter of consideration.

Q. And you certainly wouldn't get actuaries to agree to pay their own association 50 cents on the dollar for the privilege of being insured, would you?

A. Probably not. I wouldn't think so.

Q. But you can get lawyers to agree, is that what your testimony is today?

A. Evidently they have. They would appear to [2693] have agreed to go along with that.

Q. They certainly have. Do you know to what extent the members have agreed to go along with this over the past 25 years? How much profit has been made by the bar?

A. In dollars, percentage?

Q. Why don't we say dollars?

A. Since inception of the program?

Q. Inception is fine.

A. The 1950's? All right. I would suppose 60-70 million dollars, something like that.

Q. And the lawyers allowed their association to take 60 to 70 million dollars from them?

A. Evidently, yes.

Q. Can you name for me a single professional association, doctors, lawyers, accountants, orthodontists, et cetera, that make any profit from their insurance program at the expense of the members?

A. Not specifically. There are a number of them that are compensated for their services on a percentage of premium income basis rather than some cost accounting or cost-plus basis. So there might be some that derive some profit, but I think it would be at best a few percent.

Q. Minimal?

[2694] A. I would say minimal, yes.

Q. And in responding yesterday to the question of Counsel for the Government in terms of who keeps experience credits you talked about banks, you talked about oil companies, you talked about credit card companies,

you talked about credit insurance, and you talked about some college alumni programs, but you did not talk about professional associations because there are not any, except the American Bar Association according to your understanding, isn't that correct?

A. I am not aware of any, that is correct.

Q. Mr. Barnhart, you are a professional advisor to associations?

A. Yes, sir.

Q. You have dealt with at least four major associations? Correct?

A. That is correct.

Q. You have dealt with some of the finest insurance companies in the United States, some of the biggest, New York Life, Mutual of Omaha, John Hancock, Century, all big mutuals, and Provident Life of Chattanooga which I think you would agree is a reputable and one of the finest group carriers in the country?

A. Yes, sir, large and reputable companies.

[2695] Q. And you have represented large and reputable associations.

Can you seriously contend, as a professional actuary with your experience and your background, that the members of the American Bar Endowment did anything except permit this association to keep the money for the last 28 years for charitable purposes?

A. They have permitted the association to keep the money. I don't think I could necessarily agree one way or another that it was specifically for, in their minds, for charitable purposes. I think they were buying insurance at a reasonable price in the marketplace and that many of them undoubtedly were buying the insurance because they thought it was a good buy, that they thought it was a reasonable buy for the money, never mind the retained dividend by the ABE. I just can't imagine that that large

number of people, thousands of people would fail willingly and deliberately do this simply because of [illegible]ntable impulse. That to me is an unlikely explanation. I don't know.

Q. Well, I guess we all have our own views of human nature, but that is not the purpose here today.

Again in your professional experience—and I am just about finished—don't you know full well [2696] that if lawyers, contentious creatures that we are, wanted to change this program in the bar they could have changed it any time they wanted to?

A. I would think so, yes.

MR. GREGORY: I have no further questions, Your Honor.

MR. DENNIS: Your Honor, could we have a short break at this time?

THE COURT: How are we doing as far as expected time with this witness?

MR. DENNIS: I don't think very much longer, Your Honor.

THE COURT: Okay, let's take about ten minutes.

(A brief recess was taken.)

THE COURT: Mr. Dennis.

REDIRECT EXAMINATION

BY MR. DENNIS:

Q. Could you state for me, Mr. Barnhart, what the key consideration in your mind was in determining that the dividend received by the American Bar Association was compensation?

A. That it was money retained by the Bar Endowment that did not represent a refund to it of its own monies laid out.* * *

* * * * *

[2719] A. I think the Ohio rates are also expensive at younger ages. You reach a cross over point.

Q. Look at Oklahoma. Is $195 more expensive than $200.

A. No, $260 is more expensive than 200.

Q. The net is 105 in Oklahoma?

A. Oh, yes, correct.

Q. So every one of the Oklahoma columns is cheaper, is it not? Not more expensive?

A. You are correct if you look at the net rate. It does become cheaper for Oklahoma, yes.

Q. And you were going to point to something else? Ohio?

A. Well, I was simply pointing out that at the younger ages the Ohio rates are higher.

Q. $12 higher, and you took no account of the dividend, correct?

A. That is true.

Q. And the brochure for the Ohio bar says that it has a very favorable dividend history, doesn't it?

A. I don't recall any statements it made. In looking at that brochure all I could determine was that it did not seem to indicate what the actual record of dividends was. I looked at quite a number [2720] that were higher, but I sure couldn't tell you which ones those were.

Q. You can't name one, can you?

A. I looked at Idaho, Arkansas, a lot of plans. And at this point I could not recall which were and which were not.

Q. You can't name one?

A. I could not specifically name one, no.

Q. Let me talk about New York a second. I should have done that before. Mr. Dennis asked you some questions and got me interested again.

Can you give me one reason, one insurance reason why a member of the New York State Bar who wanted only a $100,000 in insurance would purchase ABE insurance rather than the New York State Bar Insurance?

A. No. If I were a New York Bar member and only wanted a hundred thousand I would buy New York Bar.

Q. Unless you wanted to make a charitable contribution to the ABE?

A. If I were sufficiently motivated to make a charitable contribution then I might buy American Bar Association.

Q. You are a fine person, it wouldn't take that much motivation, would it?

* * * * *

[2745] Q. Can you tell me what would cause an individual who is a member of the New York State Bar to pay $95 more going in for the privilege of having ABE insurance rather than New York State Bar insurance at age 35 to 39?

A. Again, you know, it's obviously hard to say for any individual. I think there would be two or three likely things that I would deem to be the most probable. One might be that for whatever reason he hasn't been paying attention to the New York State Bar mail.

Q. I think we assumed full knowledge in the Judge's hypothetical statement to you.

A. Okay, he is saying he is aware?

Q. Fully aware, fully informed.

A. In that event I think it would have to be—if he chose the Bar Endowment plan in lieu of the New York State Bar plan, it would have to be either that he just felt the Bar Endowment program had better guarantees or he was mad at the New York State Bar. I don't know how many of them might be mad at their state bar associations. But there would be some bias in his mind, some reason in his mind why I don't like the state bar plan but I will buy this one.

[2746] Q. I am correct that the New York State Bar plan had guaranteed rates and the ABE plan didn't, so a fully informed person would not have that bias?

A. No, he shouldn't have.

Q. So you can't think of a rational reason why someone would choose the American Bar Association Plan over the New York State Bar plan?

A. I would doubt,—I would be inclined to doubt that whatever reason is there that it would be a cold rational reason.

Q. Could we not agree that that would be even more correct for someone who was a second-year member of the New York State Bar plan who would have to pay $189 more to seek ABE insurance?

A. That is right. Once a person enrolls in one of these association plans they are a great deal more likely to stick with it, whatever it is, than to switch to another plan.

Q. Do I understand as to Table 1 in response to Judge Kozinski's questions you told the Court in effect there are a number of features on individual insurance that make it more attractive than coverage under association group insurance?

A. Perceived to be.

Q. Perceived to be?

* * * * *

[2873] Whereupon,

EDWARD E. MURPHY, JR.

a witness called for examination, having been first duly sworn, was examined and testified as follows:

MR. WATKINS: Your Honor, we want to thank Mr. Murphy for waiting while we finished qualifying Dr. Plotkin, and for his time to come out here from St. Louis. He has a small firm and he cannot take a lot of time from it. So we will keep you as little as possible, Mr. Murphy.

THE WITNESS: Thank you.

DIRECT EXAMINATION

BY MR. WATKINS:

* * * * *

[2878] Q. Would you explain what you mean by an attractive proposition?

A. It was cheap.

Q. And would you have said the same thing about the disability insurance, why you purchased that?

A. Could I add another reason? In 1955, I left my position with a large St. Louis law firm and went on my own and it was a scary proposition and I was looking for all the security I could find. So that was a very traumatic year for me was 1955.

In 1961 basically it was the same thing, I felt that – well, in 1961 I had formed our firm of Murphy & Kortenhof, we formed that in in 1960 and we had the rent and salaries to pay so I was concerned with what might happen if either of us were disabled.

Q. Were there any other reasons why you bought the insurance?

A. Well, basically financial security in the event of illness or accident.

Q. When you bought the insurance, were you aware that the American Bar Endowment received the premium refunds?

A. I remember that very clearly. In the first application that I signed back in 1955, I remember. There was never any doubt in my mind that that is the [2879] way it worked.

Q. As a term of the contract, of the application, how would you characterize that term as part of the contract?

A. The term?

Q. Yes, would you say it was boilerplate or a term you could not change?

A. As I recall it, it was not an optional thing. You either agreed to that or didn't get the insurance.

Q. And you did sign the application that stated in effect that you assigned the right of your refunds to the Endowment?

A. Yes.

Q. Have you deducted on your tax returns the amounts the Endowment notified you were considered charitable contributions for this?

A. I have deducted it every year that I was told to do it, and one year it was disallowed.

Q. You were audited?

A. Yes.

Q. Do you recall which year that was?

A. I was audited several years, and it was disallowed in 1977, as I recall. The other years, earlier years it passed without any argument.

Q. Are you satisfied that the way the [2880] insurance – with the way the Endowment insurance program is operated?

A. I am not satisfied with the way they handle the dividends.

Q. Have you complained about that?

A. Yes, I have.

Q. I have handed you Exhibits 1411 through 1415. The Exhibit 1411 is a letter you wrote in 1969 to Mr. Bredell. Do you recall complaining about that, the dividend feature, before 1969?

A. I don't think I made a formal complaint about it the way I did with this letter, no.

Q. Might you have talked about it with your friends or acquaintances who were among the leaders in the Bar Association?

A. I probably did. I can't be specific.

Q. I would like to ask you to read portions of these letters. With respect to Exhibit 1411 would you read the first paragraph –

MS. CARPENTER: Excuse me, Your Honor, can't we just put the papers in for the record so we can finish this witness at 12:30.

THE COURT: I think Mr. Watkins wants me to hear.

MR. WATKINS:

[2881] Q. Would you read the first paragraph of that letter and then the paragraph that begins at the bottom of the page?

A. "For sometime now I have felt that the members of the American Bar Association who participate in its insurance program have not been getting a fair deal. The form letter which I recently received over your signature advising that we are entitled to a charitable contribution in the amount of 68.7 percent of any disability insurance premiums which we paid during the period from November 1, 1967, to October 31, 1968, reinforces my views even stronger."

Then the next paragraph, "It occurs to me that the American Bar Endowment should be looking out for the interests of its members in establishing these group insurance programs and not attempting to siphon off excessive amounts of profit from its members premiums for other purposes. I have yet to hear of any major contributions to the welfare and benefit of the members of the association performed by the American Bar Association. Maybe there are some, I don't know, but in any event I do feel that this amount of profit which the Endowment is earning from our insurance program premiums is grossly excessive [2882] and should be refunded to the participants rather than to any other organization."

BY MR. WATKINS:

Q. Now, with respect to Exhibit 1412, is that the reply you received to your letter?

A. Yes, it is.

Q. Would you read the paragraph at the very bottom of the first page of that letter?

A. "I am sure you realize that the function of the Endowment's insurance activities are to provide contributions from members that accrue via dividends or expense credits to be used in the carrying out of the Endowment charter purposes in the areas of legal education and the advancement of jurisprudence."

Q. And who wrote that letter to you?

A. Well, it apparently was dictated by Richard S. Breiner but signed by someone else.

Q. Now, with respect to Exhibit 1413, you wrote that in reply to the previous letter?

A. Yes, I did.

Q. Would you read the entire text of the letter, please?

A. "Dear Mr. Breiner: Thank you for your letter of October 20, 1969 responding to my earlier letter concerning our insurance program. I am happy [2883] to know some of the details of the workings of the insurance program. The only matter I would question in your letter is your statement in the fifth paragraph that "the function of the Endowment's insurance activities are to provide contributions from members that accrue via dividends or experience credits to be used in the carrying out of the Endowment charter purposes.

"It was my impression that the principal function of the insurance program was to benefit the members of the American Bar Endowment and the incidental function was to provide contributions for the Endowment. If I am incorrect in this, then I would suggest we set up an independent insurance program for members of the American Bar Endowment that has as its only purpose the providing of low-cost group insurance for its members and let those who are interested contribute to the Endowment. I know John Lashley personally and may have additional conversations with him regarding this matter."

That is in reference to something he said about John Lashley being the head of the Insurance Committee in his previous letter.

Q. And did you receive a letter from Mr. Lashley?

[2884] A. Yes, I did.

Q. Is that Exhibit 1414?

A. Yes.

Q. Would you read the second paragraph of that letter, please?

A. "I should like to comment, however, on your letter of October 22, that clearly the principal function of the insurance program is to provide a means of raising funds for the charitable and educational purposes of the Endowment. The tax exemption would not be permitted otherwise. However, I believe you would find that the insurance is competitive with that offered by other carriers so that an independent insurance program would not be likely to save you much money."

Q. Now, did you receive a reply from Mr. Breiner as well? Is that Exhibit 1415?

A. Yes.

MR. WATKINS: Your Honor, I would like to move those five exhibits be admitted into evidence.

MS. CARPENTER: No objection.

THE COURT: You say those five? You mean—

MR. WATKINS: 1411 through 1415.

THE COURT: They are admitted.

* * * * *

[2903] A. I just think I was cutting down on my insurance premiums, I had other uses for the funds.

Q. Did you have an individual disability policy once?

A. Yes, I had an individual policy. That was the first policy I bought. It was sort of semi endorsed by the St. Louis Bar Association but it was not a competitive type policy and it had a lot of loopholes in it and I did not feel comfortable with it, particularly comparing it with these other policies that came out, the Missouri Bar policy and the American Bar policy.

Q. You still have the American Bar Association insurance, right?

A. Yes.

Q. Why did you continue to purchase the Endowment's life and disability insurance in spite of your dissatisfaction with the way they require you to assign the dividend to the Endowment?

A. Number one, I needed insurance. Number two, their rates were competitive. Number 3, I felt that other than my disagreement with them as far as the dividend policy is concerned that I was happy to be a part of the American Bar insurance program. I felt they would certainly have the clout to deal with the [2904] insurance company and see that the policies were satisfactory for the participants.

MR. WATKINS: I have no further questions. Well, excuse me.

BY MR. WATKINS:

Q. Mr. Murphy, Mr. Smith testified that an ABA member could change the program, that is the insurance program any time at an ABA meeting. Do you agree? Or at least that he could change the ABA's policy about not sponsoring an insurance program?

A. I would disagree. I tried my best to change it and I did not succeed. I don't think I could have done any more. These people were personal friends of mine that I had known through the years that I had met and conventions, that I could talk to on a first name basis, I laid out the arguments as best I could and if I did not persuade them in that way I don't know what more I could have done.

MR. WATKINS: Thank you. That is all.

MS. CARPENTER: Your Honor, I could ask Mr. Murphy to read the fifth, sixth and eighth paragraphs of that letter which were so pointedly omitted but I will simply point those out to Your Honor, and they say exactly what you would expect them to say having been skipped by the Government.

[2905] THE COURT: There were a number of letters out of which selected paragraphs were read.

MS. CARPENTER: This is the December 19, 1980 letter.

THE COURT: Is this the one I don't have a copy of?

MS. CARPENTER: It is 1420, Your Honor, I am sorry. The fifth, sixth and eighth paragraphs were omitted in the reading of juicy parts that we had.

THE COURT: I see, there are the juicy parts and then there is the gravy. This is the gravy. Fine. Five, six, seven, and eight. I see. That is it?

MS. CARPENTER: That is it.

THE COURT: Okay.

CROSS-EXAMINATION

BY MS. CARPENTER:

Q. You have been in the ABE insurance program from the beginning, right?

A. Correct.

Q. And you understand it pretty well, don't you?

A. I thought I did.

Q. You understand that the program is used to raise charitable funds for the bar?

A. Yes.

Q. In fact that is what you have been [2906] complaining about for many years, is it not?

A. Right, yes. I was not aware of the amounts that were raised until I got involved in this thing though. That was an eye opener.

Q. That was back in the 1960s and 1970s you started to realize the amounts involved in terms of percentage of your premium?

A. My first letter was triggered by 68 percent refund. That kind of shocked me.

Q. That was back in the early 1970s?

A. 1969.

Q. I stand corrected, 1969. And a deduction for charitable contribution with respect to the ABE program was disallowed in 1977?

A. I believe that is correct.

Q. And you continued to take that deduction in years subsequent?

A. Yes, I did.

Q. And I take it you would like to see the program changed and have the dividends used for the financial benefit of the members?

A. Correct.

MS. CARPENTER: No further questions, Your Honor.

REDIRECT EXAMINATION

[2907] BY MR. WATKINS:

Q. You at least want the option to determine what to do with the dividend, as opposed to having it required to be assigned to the Endowment?

A. I would like an option for myself. What other people want to do with their money is up to them. I would like an option.

MR. WATKINS: Thank you. No further questions.

MS. CARPENTER: No further questions, Your Honor.

THE COURT: Mr. Murphy, you testified that you first acquired the ABA insurance, life insurance, in 1955 when you left a large St. Louis large [*sic*] firm to go out on your own?

THE WITNESS: Yes.

THE COURT: What had you been using for insurance before 1955?

THE WITNESS: I had some individual policies that were purchased actually by my father when I was in my teens and early twenties. He transferred those to me when I got married, as I recall, or shortly thereafter, and I started paying the premiums on those, so that was my insurance before I started in the ABA program.

[2908] THE COURT: And you discontinued that—

THE WITNESS: No, I still have those.

THE COURT: I see. So the ABA insurance was not a substitution for anything, it was an addition?

THE WITNESS: Additional, right.

THE COURT: Thank you very much. Anything further?

(No response.)

THE COURT: Mr. Murphy, you are excused.

(Witness excused)

Whereupon,

IRVING H. PLOTKIN

a witness, called for examination, having previously been duly sworn, resumed the stand and testified further as follows:

* * * * *

[2930] A. But I was forming an opinion on the case from looking at the documents and I asked them to find and to look with very much diligence, and I did, too, any documentary evidence which say, and I realize I am jumping ahead to the conclusionary thing but this is an important basis of my testimony—one contemporaneous document that said it doesn't matter that this price is not—the price we charge for our insurance is not very attractive in the market because we have what I say in economist jargon very inelastic demand, because people are motivated to buy the insurance because they want to give charity, not because they want insurance. I phrased that in 6 or 7 different ways and I asked for as exhaustive a search as could be made, and I think I asked you and your colleagues to call to my attention anything that said that. And the reports I made of my own searches and all the information I got back seemed always to say just the opposite. I think I have had some questions in depositions, or I participated in depositions where the question was asked, is there any document which says we can raise this price because people really don't buy it for insurance, it is a vehicle for giving charity, we are not to worry about the price [2931] elasticity of demand, what would happen if we raise our price, or we do not have to keep the price within a competitive orb, we are, if I can use the word, hors de commerce, outside of commerce, in terms of how we have to price ourselves. And I saw not one statement like that in the documentary records and I saw literally tons of statements that work the other way. And I saw a

constant worrying as to whether we were within this envelope of normality, envelope of competive activity done not in light of this lawsuit, but done for parochial purposes at the time. Done by the insurance carriers for their purposes, independent of the ABE's case, and done by the insurance carriers with respect to their ABE client. That was a constant monitoring back and forth of the market, and never a statement "Well, we charge more but it really doesn't matter because people regard it primarily or even secondarily as charity, we can get away with the higher price." And this is what most of the search was for, and the search turned up quite the opposite. And I don't know how many thousands of pages of documents were looked at in that regard. I am not prepared to say that there isn't such a statement somewhere. But I am prepared to say unequivocally I have not found it.* * *

* * * * *

[2941] A. The net, after all costs are satisfied, when you deduct all costs from the gross revenue received or the total premiums the members pay, you get what I have called pi, profit, and sometimes it was called contribution. Although contribution was used to mean total premium contribution, because that is the official insurance lingo for it, meaning revenue, but you can say this was the gift that the members gave to the ABE. One way of measuring the gift. So that is where I think—I think that identifies all these symbols in terms of the words used to discuss the ABE operation. If I have not made myself clear, please ask.

Q. Could you from that analysis determine whether an activity is conducted in the commercial competitive fashion?

A. Absolutely not. It can only give you a part of the story. Because I could write precisely the same analysis down if I wanted to stipulate that I am considering

something which without doubt is a charity, wanting to maximize the contributions it receives. [2942] While it would never talk about it in these words it would go through the same calculus, pi would be the total contributions. The total contributions are net contributions that really has at its disposal the total gross receipts from people it solicits, minus the cost it incurs in receiving them.

Think about a charity who wants to raise funds we selling tickets to an opera gala. First of all, should we sell all the tickets at the same price, should we have front seats for people who give more and back seats for people who give less. But as I set aside that question, should we charge $100 a ticket, $150 a tickets, $200 a ticket. The more we charge per ticket, the higher will be our profit on each ticket. Again assuming that somehow our costs vary with the number of tickets we sell, which is perhaps not a good example, because it is a fixed cost operation, but the less total number of tickets we will sell. So in determining price on the fundraising activity, they would essentially go through the same type of analysis. So I don't believe that you can answer the question as to whether or not something is a commercial activity merely by looking at whether it has satisfiied the usual businessman's calculus of maximizing pi, maximizing profits with concern for the effects that P [2943] has on revenue via its effects on quantity.

* * * * *

[3042] BY MR. DENNIS:

Q. In light of what you have laid out, can you explain I why the ABE's insurance programs are so profitable from an economist's standpoint?

A. Well, yes. Because the ABE has a very valuable I will call it asset, that is the word I use as an economist, very valuable intangible, if you will, when viewed by the insurance carrier. It will allow the insurance carrier via the

ABE access to a very [3043] special subportion of the population, which they could not get access to without a special product and special prices and alleged to be specially designed for that subportion, namely the attorneys.

And it could do so by having advantages of group selling of insurance, using direct mails, direct marketing, not using an individual agent who individually would visit each insured. By the way, in some cases, association insurance as we have heard is sold by individual agents. The association together with the insurance company employs the individual agents for their somewhat lower than standard but yet individual insurance agent's commission.

These commissions as we have heard have run 50, 60, 70 percent at least of the first year premium when sold. Not having the individual agent and the attendant costs of visiting each individual, the association can offer its members insurance that is attractively priced compared to their normal and natural alternatives, and the alternatives that are forcefully presented to them, mainly that by agents, now even some by direct mail. Yet, while the price paid by the individual is lower than his alternatives, the association in turn in dealing with the insurance company can bargain for a much lower price for itself [3044] on the wholesale level, so to speak, because the company would have no way—by dealing with the association, it is not losing business it could otherwise get that directly and it is not losing a very sure flow of business. One way the deals are set up where the association takes the first layer of uncertainty and the insurance company will not likely lose money—it has a margin of protection almost 50 percent on its chance from a normal insurance policy of whether it would ever wind up in the whole because of untoward actuarial risk. The only thing that no one seems to have protected against here is some large calamity, an ABE meeting. It doesn't seem that one possibility is covered in some sense. But in the general sense, the insurance com-

pany gets a very good deal, gets access to a population he cannot separately access. The association can make an attractive offer for the individual and still make a very high profit on what it sells. That doesn't mean that if it chose to make a lower profit it wouldn't sell more insurance to its members, but even those who buy at the higher price than it has to charge can still get a good deal and the association can wind up with what appears to be a high profit per dollar of premium. There is nothing mysterious about it.

* * * * *

[3048] I think you have indicated that you have heard their testimony. Has that phenomenon been adequately described by the witnesses, including Dr. McGill?

A. Well, I think in general by now there has been a very good general description. I think perhaps Ms. Khachadour from her own experience as a regulator in California gave the best general definition. Dr. McGill just said he was I think somewhat familiar with it and that it could exist in the association where the association benefits from the experience—benefit of the association is a function of the experience on the group policy sold that is.

I would say the most important points to emphasize is that the power is because the association or the intermediary is the one who effectively chooses the insurance carrier, and as an economist, I would probably say that we would—the general economic words would be there is an incidence of market power that the association has won over the carrier and to some extent even over its membership, although this doesn't mean a pejorative connotation.

Q. In addition to the high profits earned by the Endowment is there any other evidence of the ABE's market power vis-a-vis the carriers it has selected to [3049] provide insurance to members?

A. Carriers it has selected? Did I hear right?

Q. Yes.

A. Yes, I think we mentioned what might be called the annual tribute which wouldn't be worth mentioning except for the fact that it is an example of the very kind of thing and the same type situation that was specifically pointed to by the California Insurance Department.

I think the fact that the words of one of the Mutual of Omaha witnesses, "the ABE sets the price of insurance" well, that can't be strictly true. Legally I think the carrier has to set the price, but I think saying effectively that the intermediaries set the price of insurance.

I believe the unique escrow arrangements, at least that is what I heard at the trial, for the ABE's business than for the business of other associations, meaning to me that the ABE has perhaps a better bargaining position because of a better maybe mortality, morbidity experience of its members.

The cash flow or the float on the premiums seems to have carefully been worked out to the advantage of the ABE. And this is really something—a tribute to Mr. Breiner, because one thing insurance [3050] companies have been generally expert in doing is having the cash flow work to their advantage, giving rise to investment income, so much so that in current years, most of the income from the insurance company comes from investment income and not from any underwriting profit it may make.

But when you deal with the clever intermediary like an independent agent who has a good book of business or an association, that is where the carrier often has to give up some of the float to the intermediary.

Another evidence or maybe just evidence of the basic phenomenon was that the association was able at the drop of a hat really to stick carriers on the medical plan, I think, when it wanted to, and get a better bid from one carrier versus another. That is the carrier would lower its retention rate. Retention rate is meaning how much profit the

carrier makes out of the business. This is a very interesting bargain. I can't go to an insurance company and say sell me an insurance policy where rather than going for your usual 5 percent underwriting profit margin I want you to go for 2 percent, but in fact that is what happened in the bargaining between the association and the carriers.

[3051] In a sense the association vis-a-vis the carrier basically had all the marbles, all the bargaining chips. As far as I can tell, it has exercised every one of them. And again, there is nothing wrong with doing that, but I think it is an indication of the relative bargaining positions of the individuals.

There are a huge number—if you take all the companies that qualify to write life as well as accidents and hell we are talking about thousands of insurance companies, there is only one ABA and one ABE to give you access to that broad national membership.

Q. Dr. Plotkin, wouldn't it follow that the retail consumer that you have described, in this case the ABE's insured members, would necessarily have to suffer if the ABE makes such profit?

A. No, I think we have adequately discussed this before—

* * * * *

[3128] A. But I think it was. I know I entered into no kind of recruiting negotiations with him. I did before submitting his name to the Government check out his willingness and I remember him saying his major concern was the time commitment it would involve and I advised the Government of that.

Q. I am not sure which question elicited that response.

A. You asked if I recruited any witness and the only one that word can come anywhere near is Mr. Barnhart's.

Q. Did you ask any person who is listed as a witness but did not testify to testify for the Government in this case?

A. Well, I did approach Ms. Furth to ask her to work on this case.

Q. She is a colleague. You know I am not interested in that.

A. Well, what you would have to show me, sir, is—I think the answer is no, but I don't have the witness list before me.

Q. Let me ask a different question then. From the time you were hired as an expert in this case have you ever approached any individual at any time anywhere and suggested to that person that he or she [3129] testify for the United States in this case?

A. I think the answer to that is yes in a somewhat trivial way, which I think I should explain to you.

Q. Please do.

A. As part of my normal work, not necessarily related to this case, I see a lot of attorneys and I work with a lot of attorneys in an insurance regulation-insurance business setting. Also I am related to an attorney. And I think I asked my brother-in-law whether he had ever bought this insurance—I didn't seek him out or phone him to ask that question, but just "By the by, what are you doing," and "By the by, did you ever buy this insurance," and I was surprised when he said yes.

Q. What is the name of your brother-in-law?

A. John Bufe. And I was surprised when he said yes, because I knew he was as poor as a church mouse for many years. And he had also just completed a move out of Washington, D.C., where he had worked for a labor union to join a firm.

Q. You are saying you made a trivial suggestion to him that he might testify?

A. Well, yes, in fact I said I will mention this to the Justice Department people because I know [3130] you have just moved to Texas and this might be a way of your getting a trip back to Washington, D.C.

Q. And in fact he appeared on their witness list?

A. I am not sure of that.

Q. And in fact I was trying to get his address to subpoena somebody down in what's its name, Texas, that he was on the list?

A. I agree it is a what's its name for sure. So I was sure the allure of coming back to the big city—

Q. Other than your brother-in-law have you asked any person in the world to be a witness in this case?

A. Again even further removed, but jocularly I discussed this question with an attorney I am quite sure not named on any list who used to be Deputy Insurance Commissioner of California, again "What are you doing, what is keeping you busy lately," and he said that he did buy one of these products. In fact he made a very careful study when he left Government service, and including his dues to the ABA which he would not otherwise pay, it was the cheapest disability insurance he could get and I said "Would you be willing to testify to it," and he said "No," [3131] and he gave me an interesting reason.

Q. Point of fact: You solicited him to testify for the Government in Tampa, Florida, at the NAIC meeting on September 19, 1983, did you not?

A. Solicited would be a very strong word. I think it was at an NAIC meeting, and it must have been in Tampa I had that discussion with him as part of taking the opportunity to ask people who I knew understood the insurance world and was also an attorney what he knew.

Q. He is also a former Deputy Insurance Commissioner or Director in California; is that correct?

A. I said that.

Q. And you asked him to testify for the Government in this case, correct?

A. No, I asked him would he want to, would he be willing, should I put his name to the Government.

Q. I am sorry, I misunderstood.

A. I had no authority and it was in one brief conversation more as "Would you say that, would you be willing to say that," and he explained to me why he would not be willing to say it.

Q. Who else did you ask to testify at the Tampa meeting of the NAIC on September 19?

[3132] A. I don't recall. Well, I discussed this with a large number of people, again in a passing mode, "What is keeping you busy, what are you doing." Also sometimes doing a little bit of brain picking, "What is your personal history with respect to this."

Q. And this is three days after we had received your opinions as an expert in this case?

A. That is true. I continued to brain pick and look at anything that I could find. I don't know that any other conversations would you testify or would you be willing to testify, shall I tell the Government to interview you, maybe they would find your story interesting type. But I talk to a lot of people and it is the usual topic of conversation at an NAIC meeting where you run into people you have not seen for either six months or at least three months, catching up on what you are doing. Especially when you, as I was working on something which in a wholly different setting, the tax setting, was still very much the nature of the work of these people and involved the law and involved insurance. I am quite sure I spoke to lots of people about it. But I was not out looking for witnesses to testify.

Q. You were not out beating the bush for witnesses?

[3133] A. I was not out beating anything. I was however sensitized to the fact that this is an opportunity to get very frank opinions on what made people do what they do; a very, very difficult question ever to grapple with.

Q. Did you attend a meeting of the Medicare supplement and other limited benefit plans (B) task force of the NAIC in Tampa, Florida, September 19, 1983?

A. I did indeed.

Q. Am I not correct, sir, that a transcript was made of the proceedings of meetings of that task force?

A. I think in that case a transcript was made at that time of that task force. It was not uniform that task force meetings of the NAIC are reduced to transcript form.

Q. Am I not correct that Commissioner Mikelow of Arizona was present and presided at this meeting?

A. I think yes, he was chairman of the task force.

Q. And Commissioner Don Ainsworth of Missouri was present?

A. I believe so.

Q. Am I not correct, sir, that the purpose of the meeting was to consider whether the NAIC needed to [3134] develop additional model laws or regulations governing direct mail insurers and out of state trusts?

A. Well, in part. It was also to receive reports relating to those matters.

Q. And at that meeting did you not rise and ask a question from the floor?

A. I did.

Q. Did you not inquire whether in connection with association group policies any of the commissioners were aware of any law or regulation which would affect the situation where an applicant for coverage under a group policy was required to return the dividend to the policyholder?

A. Precisely.

Q. And did you not state—

A. Think those are my words.

Q. Did you state the purpose of this question was you were simply "brain picking"?

A. That is just what I was doing.

Q. And just what you said. You did not disclose that you were an expert witness in this case having already formed your opinion on this subject, did you?

A. In asking the question of the commissioners in their formal session, I said I was brain picking to [3135] know whether there is any law in any state. I had about a dozen different insurance departments represented on that committee that would prohibit the preassignment of dividends as a condition of obtaining association insurance.

Q. Did you receive any response to your question?

A. I didn't receive a definitive response. I interpreted the response I received as saying that they don't think that that would be permitted by law but it seemed to be unclear in my mind and perhaps they would look at it. It was a kind of unfair question to put to them even in that, the appropriate task force.

Q. Did not Commissioner Ainsworth of Missouri state to you in response to your question, Dr. Plotkin, that it would seem to him that the practice that you described would adversely affect the marketability of the insurance product in question?

A. He may or may not have. I just don't recall, sir. I am sure there is a transcript of it and it would say what it says.

Q. But your recollection now is that that may or may not have been his response?

A. The question I asked, sir, was whether there [3136] were any laws that prevented it and it was to that question I received no definitive response other than we would look.

Q. You were told by a state insurance commissioner at that meeting that the practice in question would adversely affect the marketability of the product and we have not heard any reference to that in your testimony, have we? That calls for a yes or no answer.

A. I have not referred to Mr. Ainsworth's comment, you are right.

Q. Am I correct that the last time you testified in Court was in the Mobil Case in the Court of Claims in July of 1983 for the Department of Justice?

A. Yes, sir.

Q. How much were you paid in that case? How much was Authur D. Little paid in that case?

A. You have probably reviewed the transcripts more recently than I. Could you remind me of the number? I don't have it.

Q. May of 1983 you testified for the Department of Justice in Colorado, did you not?

A. Yes.

Q. How much time did you put in on that case?

[3137] A. I have no way of remembering how much I put in on the Colorado case. I am sure time records would show.

Q. How much time did you put in on the Mobil Case?

A. Again, as I sit here now I don't remember. A lot more time on the Mobil Case than the Colorado case I am sure.

Q. 1981 you testified for the Justice Department in the Claims Court on the valuation of good will and stock?

A. Primarily the valuation of good will of the Studebaker Corporation in 1911, I believe. Stock came into it because it involved a capital market and the stock market of that day, and the so-called watered stock.

Q. Do you know how much you were paid in that case?

A. No, sir. First of all, you always mean Authur D. Little and I don't know how much Arthur D. Little was paid.

Q. Is it not fact, Dr. Plotkin, you have printed on Authur D. Little stationery questions and answers that you send to counsel so you can be qualified as an expert witness?

[3138] A. What I have is a typing that my secretary did from a transcript a number of years back of Q and A to not sensor [*sic*] but to give to counsel if they want to know questions that will bring out what areas I worked in, and it came about by one counsel having done a very thorough job on a record and I asked my secretary to reproduce it, so we don't have to each time sit down and talk out with counsel what questions should you be asked in terms of your experience outside of the instant case.

Q. Let me ask you about this case:

What did you mean on Friday when you said that the role that you had taken in this case, or Authur D. Little, was unprecedented in your experience?

A. Sir, can I start by saying what I did not mean, because I think I may have misled you based on an earlier question.

Q. No, tell me what you meant.

A. It meant the degree to which my colleagues, primarily Ms. Furth and myself, were requested to actually write out, give, suggest questions to counsel in what I call real time, during depositions, during trial. While there is always some of that involved in being an expert, in terms of the matter of degree of how much we were asked to do, that it seemed to me [3139] that this was more than I had ever experienced before. I think I understood the reasons for it, and the necessity of it, but it was outside of my usual experience and involvement with the case.

Q. And it made you very nervous, didn't it?

A. It made me uneasy, because as I said I think during direct I would not do such a thing in a subterfuge, writing out questions and suggesting questions. If so I would make it obvious I was doing so, and I was worried that it might have the appearance of impropriety and I checked a number of times and was told that that is not improper. And where in my view I want to be very sure that I understood what was said and had the opportunity not of having to read a deposition and say "Oh, I wonder what he

meant by that or what would he have said if asked such and such, had I the opportunity to actually suggest that the questions be asked," that that is an appropriate role. I suppose part of the reason is generally when I come in a case much of the discovery has already gone on, the discovery certainly of all the fact witnesses has generally already happened, and I have the unenviable position of just reading the depositions without being able to control whether the words are used in the way of having meaning to me. So [3140] it was unusual and outside of my experience to be involved in the case at such an early date vis-a-vis the discovery of fact witnesses. It is not unusual to participate in the deposition of an opposing expert witness.

Q. All right, now, you participated, you or your staff, in a lot of depositions other than expert. You sat in Chicago a day and a half with Ms. Locke?

A. I said that was the unusual part. I consider that discovery of a fact witness and usually I don't have the ability to be a part of the case while that is going on. I get their deposition as it has been taken and I am told read it for what it is worth.

Q. In this case there is no problem for you because the script of the depositions was written by Authur D. Little was it not?

A. I don't think that is a fair way of saying it.

Q. Who sat there and passed questions all day long to the United States Department of Justice lawyers?

A. Sometimes when I was there I passed questions, sometimes when Louise was there she passed questions, but I don't consider that writing a script [3141] for them. But it is certainly suggesting questions to ask. More importantly I think sometimes suggesting follow up questions and being sure that the words are used right.

Q. Let's direct your attention to the deposition of Dr. McGill.

A. Yes, sir?

Q. This is after you reaffirmed your opinion of September 16 by the witness papers being filed on September 30.

A. Excuse me, can I just with that prologue say I don't recall doing anything vis-a-vis the Government in the period between September 13 and September 30. There was no active reaffirmation.

The research certainly was continuing but I did not—I don't recall being a party to that so-called reaffirmation.

Q. You sat at Dr. McGill's deposition on Mr. Dennis' left hand whispering in his ear all day long?

A. Indeed I did.

Q. To the point where I had to ask you on any number of occasions to please let Dr. McGill finish his answers before you commenced your whispering?

A. Yes, you did.

Q. I had to ask you to stop tugging at Mr. [3142] Dennis' sleeve and give Dr. McGill the chance a gentleman should have to respond to your questions?

A. At one point, after you asked me to stop whispering at him, I tugged at his sleeve to get his attention before he went onto the next question and you then asked me to stop tugging at his sleeve.

We progressed by the time of Dr. McGill's questions to your saying you had no objection to my suggesting questions in between the answers as you objected previously.

Q. All I was asking you to do was listen to the answer, right?

A. Yes.

Q. Am I not correct among the papers on your desk Friday were both the proposed and final rules of the Federal Trade Commission giving administrative law judges discretion to allow a non-lawyer expert to cross-examine another expert and to do so as an advocate?

A. I don't know about the last portions. I really have not had a chance to read them. There was the proposed and adopted rules of the FTC that would allow one expert to cross-examine another expert in his own field.

Q. And you carried them to the witness stand in [3143] this case?

A. They were in my file, yes, sir. I had received them while I was here in Washington.

Q. And—they were not in your files. They were laid out on the table, because that is where we got the papers from Friday.

A. I am telling you they were in the one file that I brought and spread out onto the table.

Q. As I understand your testimony, this unprecedented methodology for organizing and managing depositions in this case was necessary because the Government attorneys could not understand insurance terminology and insurance market conduct; is that correct?

A. In part it seemed to me that it was necessary in part because when I asked that certain areas of economic evidence be explored I had great difficulty in achieving understanding in what I was saying; the subtle differences in words that were used in insurance, that this seemed to allude [*sic*] them.

Q. Subtle differences you mean in individual insurance, in term insurance, in group insurance, in gross premium, net premium? Are those the subtle differences we are talking about?

A. Yes, for some people it is apparently very [3144] subtle.

Q. And Mr. Dennis just doesn't have the experience to do that?

A. Mr. Dennis is rather lacking in the experience that I could tell about these terms and economic terms.

Q. Did you ask Mr. Dennis about his experience in this Court in insurance cases?

A. No, I made that judgement based on his performance in the instant case, sir.

Q. Did you ask him how many cases he has handled in this Court involving insurance issues and insurance companies?

A. That was not relevant to me.

Q. What about Mr. Markham, did you check on his experience and capability before you took control of the depositions?

A. I don't believe I took control of the depositions. I believe Mr. Markham did depositions—I know he did depositions and I was no part of the depositions that he did. And—

Q. We had five or six in a day so I would stipulate you wouldn't have been at every deposition.

A. Maybe you should make clear that I was at Ms. Locke's deposition, the beginning of Mr. Zumbrook's [3145] deposition, another very short deposition that interrupted Mr. Zumbrook's deposition by a gentleman who had worked as an insurance age administrator. And then Dr. McGill's deposition. Those are the only depositions I was in. You make me sound as though I had more arms than I have.

Q. You had associates. Ms. Furth was in Omaha for a dozen depositions; is that correct?

A. She was in Omaha. I don't know how many depositions were taken there.

Q. Did I understand you to testify you had a chance before his testimony to meet with Mr. Gardner and to discuss your respective vocabularies?

A. If I said at least that I met with Mr. Gardner the morning—I think it was the morning before his testimony, but rather it was the same morning I am not sure. I do remember a breakfast meeting. In fact I think there were two breakfast meetings; one the day before his testimony and one the day of his testimony. But in both cases I really joined in on the breakfast in progress, stayed for a while and went off to other appointments.

Q. Took no active part in it?

A. Oh, while I was there I had an active discussion, participated actively in the discussion.

* * * * *

[3156] BY MR. GREGORY:

Q. During the course of your examination of Endowment documents, Dr. Plotkin, you obviously would have had to have looked at the annual notice to members of the amount of charitable constriction; is that correct?

A. I saw a number of such exemplatory notices.

Q. And you saw literature going back certainly to 1972 and beyond, that explained the purpose of the insurance program as a charitable fundraising effort, did you not?

A. Yes, sir.

Q. Now, can we not agree that a lawyer being told, for example, in the life program in a given year, that he had a charitable contribution of 50 percent of premiums, is capable of reasoning that if the money [3157] had not gone for charity his association could have provided insurance for him at 50 percent less?

A. I think a lawyer who thought about it could have concluded that the American Bar Endowment could have provided insurance for less. A good tax lawyer from everything I hear today might have concluded that the American Bar Association could not have done that, or at least they maintain that they couldn't have done it without losing their tax exempt status.

Q. There is no question he could have concluded that the American Bar Endowment could have provided it at 50 percent less?

A. I think he could have suspected that. He might wonder whether the Endowment could strike a deal that the association couldn't for some technical reason or that, but if he thought hard about it I think he could have realized that one or another of the association A1 aspects of the American Bar Endowment in large could have provided insurance at a lower price to him.

Q. If the lawyer thought real hard he could have figured out that the 50 percent that went for charity could have gone to him?

A. Yes, sir.

Q. Let me make sure I understand your testimony.

[3158] A. You know, when you say thought real hard, I said thought about it. Is capable of thinking about it. I wouldn't want to speculate whether he did or didn't think.

THE COURT: Dr. Plotkin, you must not take everything Mr. Gregory says literally. Sometimes he just says things.

THE WITNESS: Okay. Well, I just get uncomfortable when he characterizes what I said.

MR. GREGORY: Then I won't characterize what you just said.

THE COURT: Keeps things lively.

BY MR. GREGORY:

Q. In order to reach the conclusions you have reached, Dr. Plotkin, has it not been necessary for you to set aside all of the statements by the Endowment concerning the purpose of the charitable program?

A. Absolutely not. I didn't set them aside, I set them right in front of me when I considered the question does notice change the economic answer that I have received. Setting aside is to ignore, to put to one side. I don't see—I thought you said you were not going to characterize any more? It is such an inaccurate characterization.

[3159] Q. Why don't you just answer my question?

A. I am trying to, sir.

Q. Thank you, I really appreciate it.

Now, the bottom line of your testimony is that the American Bar Association as a business has been able to generate over 63 million dollars in profit from the administration and operation of one group insurance program?

A. I think the 63 million dollars is the sum of all dividends they received, less expenses from the commencement of the program.

Q. That is correct?

A. Well, from the operation of a number of such programs, yes, sir.

Q. Well, one program, five different policies, is that what you have in mind?

A. They call them different programs.

Q. All right, from the management of insurance programs for one group, the Endowment has received as profit, according to your economic analysis, 63 million dollars?

A. Yes, sir.

Q. Can you point to any group insurance program in the United States that has achieved such successful results?

[3160] A. Using the technical word of group insurance, which you just used, many lenders running group insurance programs have received—have produced results that dwarf these results by miles and miles.

Q. Are you talking about credit insurers?

A. Yes.

Q. Credit insurers who don't disclose to their insured what their profits are?

A. In general, yes.

Q. Don't even disclose the fact that there is profit? Is that correct? Credit insurers who are dealing with people who are purchasing insurance in the context of a loan transaction? Are those the people?

A. Those are at least one group responsive to your question.

Q. And the same credit insurers whom Ms. Khachadour said abused consumers and had to be regulated? Is that a group?

A. That is a group.

Q. Well, putting aside that group, who else within the general—the biggest definition you can think of of group insurance, who else has made this kind of money on an insurance program?

A. We talked before about title insurance as [3161] another example of the role of an intermediary, but that is not strictly group insurance.

Q. Well, it is a captive group, though, very analogous to credit insurance in that somebody is looking for a different commodity and dealing with a captive insurance company, not technically but in the sense of the title attorney or someone else recommending that company; is that correct?

A. That there is an intermediary who selects a carrier to provide the coverage to the underlying consumer.

Q. Another area that has been alleged to be quite abusive?

A. Yes, sir.

Q. Well, all right, we have covered credit insurance and title insurance. Who else, what other type of group policy in the broadest sense, group policyholder, has achieved these kind of profits?

A. You talk about the broadest sense, as you do, which admitted title insurance, which is not written under a group—

Q. I didn't quibble with your answer to that.

A. I know, but I have to continue in that vein.

Q. Just give me anybody who has made that kind of profit?

[3162] A. Many commercial agencies who work on an individual—we would need the flip side of that blackboard.

Q. You can flip it over.

A. —who work on an individual—who sell insurance to individuals, would have made dollars much larger than those in relationship to their sales of individual life in-

surance to individuals, although if you scale their dollars by the gross premium charge, they are not as large as the ABE percentage.

Q. And you also don't know whether what they made is profit, do you?

A. I don't know company by company. I do know that pieces of it are fairly profitable.

Q. We are talking about 63 million dollars in profit. Since you flipped the board, go to your box where association is. We will pick up these groups one by one. He talked about lenders already. Mr. Gardner testified that fictitious groups don't make any money and nobody is getting in it any more. You don't disagree with his expert testimony, do you?

A. I know that they are kind of whithering [*sic*] on the vine, like. Some of the original promoters made a good bit of money.

Q. The robber barrons of the insurance industry?

[3163] A. I would say probably the robber scoundrels because they are not around to donate large public plazas, so scoundrels.

Q. I will accept that. Again focusing on the box, Mr. Gardner says fictitious groups can't make it, let alone 63 million. We talk about credit card people. Now, credit companies, are they making 50 percent of premium?

A. I mean the credit card—

Q. American Express. There are documents in this case dealing with Firemens' Fund and American Express. You reviewed the documents. How much does American Express get for the insurance program, what is their profit?

A. Well, let's see, American Express is dealing with selling the insurance of a subsidiary.

Q. And we know from your testimony in the Mobil Case that that doesn't count, right?

A. Oh, no, it counts when they sell it to third parties. It is that American Express cannot obtain insurance for itself by dealing with its own subsidiary.

Q. I stand corrected. What does American Express make?

A. I don't know the rate of profit. It also is [3164] a product that has only recently been started, it doesn't have the 20-odd year history of the ABE.

Q. You can't name a credit card company that is making anywhere near the rate of profit the Endowment is making according to your economic analysis, can you?

A. I don't want to even give you the implication otherwise. I cannot name a credit card company that is making the same rate of profit. Some of them may be making the same dollars but they are using a much higher volume.

Q. And some of them can be losing money on their insurance program, too, can't they? Is it not a fact that many credit card companies are in insurance not to make dollars on the insurance per se but to bind the credit card users to the use of their particular credit card?

A. That is possible, but there is very little marginal cost for them in operating the—getting into the insurance programs, basically stuffing things into their mailing.

Q. Did you review the Firemens' Fund depositions in this case?

A. No, sir.

Q. Let's put aside the credit card companies. That leaves us with associations. Mr. Gardner and Mr. [3165] Barnhart, two expert witnesses for the Government, said they couldn't name any association that has come anywhere near American Bar Endowment in terms of making profit. Do you recall their testimony?

A. I do, sir.

Q. Am I not correct ther. in the box that you drew on the board, association, credit cards, lenders, fictitious groups, the only entity that sits there, sits at the top of the

heep [*sic*], in fact is the heep [*sic*], is the American Bar Association? Isn't that correct? In terms of profit?

A. I think you just—when you went back over that group, you put in lenders and we talk about them separately. And when you put in associations you asked me about their testimony and I think you properly characterize their testimony. But if you look at an association and bring in the broker administrator, and look at some of the numbers that were entered into evidence by Mr. Steinig which showed the remuneration tables that New York Life uses, and they are one of the most cost-conscious controlling companies of all of them in this regard, you could see how the gross flow to an association or its broker administrator in terms of commission and allowance for expenses, could go to 35 percent on new business, or [3166] 34 percent on new business approximately, 20 percent on renewal business. And while that is only the gross, it is certainly more than the monies made on two or three of the ABE programs. So I don't think that you are completely out of striking distance. On the other hand, in saying that, I don't know enough about the facts of life of every association to make a definitive statement that there is nothing else like the ABE. I will say that I know of nothing as high and nothing has been brought into this record, excluding what happens in the case of title insurance and credit insurance, that shows those kind of rates of profitability per dollar of premium on at least two, maybe three of the plans.

Q. You have testified to three on Friday and this morning, did you not? And you testified over a ten-year period. You never addressed in this case the amount of profits made during the tax years in issue, have you? That is yes or no?

A. My testimony has never specifically addressed that.

Q. Because it is a lot higher than what Mr. Dennis represented whether he is correct or not, to be ten-year averages. Now, my question to you, sir, pointed you to the

box on associations. You answered [3167] the question by leaping out of the box and heading up to the broker administrator box.

As I understand your answer and as I listen to the expert witnesses of the United States of America, there is no other association, indeed there is no entity that any expert witness in this case can point to that makes anything resembling what you allege as profit by the American Bar Association at the expense of its members in this case; is that correct?

A. The last part of your question is correct if you limit yourself to associations and take out lenders and title operators president.

Q. I think your other experts have taken them out for you. All right, and you then point to the box broker administrator. You sat here and heard Mr. Gardner testify that leading broker administrators would knock on the door of the ABE to do a competitive bid on the cost plus basis for administration, did you not?

A. Yes, sir.

Q. And you know as well as I do that a cost-plus competitive bid is going to produce a miniscule profit if you assume ten capable agencies, each competing for this business and each wanting it, is that correct, as [3168] an economist?

A. Yes, sir.

* * * * *

[3175] A. Yes, from the point of view of the individual consumer that is the only place where he can measure the retail cost to him, the cost to him at the retail level of the relevant insurance to contrast with the ABE offering.

Q. The employer-employee situation would be a wholesale situation?

A. Well, in general, the general thing is it doesn't cost the employee anything. Like in my case, I get it by virtue of being employed, though I get an extra layer on a con-

tributory basis but my employer is still paying for most of my total insurance protection. My quibble with that, and more my disagreement with the IRS is that when they go to look at how much it costs my employer they have a table rather than looking at how much it actually cost him. Administratively easier, unfortunately the table gives the wrong answer. But that is not relevant to what I would have to pay as an individual for insurance because I can't as an individual buy employee-employer group insurance.

I think I may have confused issues by [3176] bringing in the employer-employee group and the IRS. I just am angry at them for it. When my employer gives me $1.00 in salary there is no question but that he has taken $1.00 out of his pocket and given it to me and it is his cost of business. When he gives me insurance, in an environment where the value of the things he gives me for tax purposes are what it costs him, such as if he gives me a car, it is what the car cost him if I use it for private purposes.

The insurance I think is valued, ought to be and I think intended to be valued the same way, what did it cost the employer. The tables say look up on these tables and we will tell you what its value is in terms of what it costs, or presumed to have cost the employer. My observation is that presumption is off. It has gotten behind the times. It costs the employers a lot less than that table says. And again, I have been thinking about this outside and long before the occurrence of this case and talking with our group insurance administrator about that problem.

* * * * *

[3188] THE WITNESS: Well—

THE COURT: By hypothesis, I mean.

THE WITNESS: I hear you. You say charged and I would ask charge to whom.

THE COURT: It always comes out of the insurance dollar, we know that. So we know it doesn't matter.

THE WITNESS: Well, in a sense I think it matters just because of the way you phrased it.

THE COURT: I was trying to plug into your terminology as best I could.

THE WITNESS: I think I understand what you are saying. What the ABE is doing is providing intermediation between the insurance carrier and a segment of the insurance-buying market. I think that everyone has more or less said that. In fact Dr. McGill—

[3189] THE COURT: I don't think it is disputed. I mean whether you use nicer terms—

THE WITNESS: Middleman may be disputed but intermediary is common vocabulary.

THE COURT: Very well.

THE WITNESS: What they are doing is not merely the, shall we say, ministerial and normal functions of general intermediation, which is checking off names and moving pieces of paper from here to there, or even the advertising function of some intermediation, but they are also—and with respect to their members they are uniquely capable of doing it—segregating a market, they are creating, making—I realize that became a disputed word so I tried to stay away from it, but they are identifying and segregating a for the insurance [*sic*].

* * * * *

[3210] THE COURT: Let me ask you then the question I asked earlier. Does that make a difference in your view as to whether or not that turns out to be a competitive enterprise?

THE WITNESS: I gave you the "No" part of that. If you look just at the models I put on and my discussion of price, you could not distill the answer. But the answer to my mind, the full answer is yes. I did not speak to that because it was not the case here. And I believe as an economist we are dealing with rational persons. We used

to be able to say rational man, but now it is rational persons. And that a rational person would try to minimize his cost to the limits of his knowledge and convenience. And if at the checkout counter you are asked do you want to pay $1.00 and get just the spaghetti, or do you want to pay $1.25 and gets [*sic*] the spaghetti and credit in the world to come, you are making a separate decision to give to charity. You clearly are saying I can get this very precise good, this very insurance policy or this very box of spaghetti two ways, either I can buy the good alone or I can buy the good and at the same time give to charity and I have elected the second. And I would have no problem at all saying that any money flowing from the election is charity. Because I [3211] believe people try to minimize the cost they pay for a product, all other things being equal.

THE COURT: The fact that buying the box of spaghetti causes you not to buy somebody else's, the fact that maybe it has Mother Teresa's smiling face on it makes it more likely you are going to buy the spaghetti, the opportunity to make an easy charitable contribution steals away the customers from the poor Mueller Spaghetti Company?

THE WITNESS: Oh, I had not thought of that range of things, and yet I just don't feel at the margin they could make a difference. But when we are talking about the quarter that you either elect to pay or not pay, the additional quarter you elect to pay or not pay, to me that seems clearly like charity.

In fact I was thinking about it, maybe subconsciously in light of this case, though I was thinking about it just because it was a decision I recently had to make. American Express is saying every time you use their credit card to buy their travellers' checks they will give money to the Statue of Liberty. I recently took my sons to the statue of liberty so I have a greater affinity for her than I would ordinarily. I say that is nice.* * *

* * * * *

[3231] THE COURT: I was trying to get back to the point I had been discussing with you a little earlier. Basically there were two of them. One is the question of the free rider and the means by which one group—you understand by the way, I don't know if this has been explained to you, but this is not feeding-the-children-in-China insurance, this is insurance that benefits the ABE—

THE WITNESS: The program is benefited.

THE COURT: Lawyers, and society in a way that relates to lawyers. It is something that provides tangible, or intangible or indirect benefits [3232] to the legal profession.

THE WITNESS: Or allows lawyers to benefit society by bettering their profession.

THE COURT: Perhaps that is the way to say it. But I am wondering about the free rider problem and the ways of guarding against it, and whether in deciding to set up a charitable organization or charitable trust, a group such as a group of attorneys might not decide to overcome the free rider problem by causing a contribution whether implicit or explicit to be made by each of its members as one way of getting more people to share in the charitable aspects of the program.

THE WITNESS: One way of overcoming the free rider problem is saying I am going to give you something of value, the insurance product. And I am going to charge you a fair retail value for it. Now, I will admit, I could charge you less than that if I wanted to. But if you buy this at a fair value to you, you will also help me, and you will also help this greater good that I serve, and other people will also be motivated to do that. Not everyone, because they don't inconvenience themselves, they are still wholly rational economic men in making that decision.

THE COURT: And women, too.

[3233] THE WITNESS: Yes, men and women. But it would be a way of overcoming the pure free rider, that anyone in the program has gotten a fair value to begin

with, and then there is something extra added on, if you will. That would overcome part of the free rider problem.

The other point you bring up, which is one of great subtlety, is that the 80 percent who don't participate, and even some who do, have effectively given up the chance of the ABA to offer them the lowest possible group insurance rate, because that would kill off the ABE program.

So I must say I cannot take at face value the statement that the ABA offering the program would confuse the members. I don't think it would put confusion in the members' minds. What I do think it would do is kill the ABE program, but it would be an acid test of whether people are really motivated to give charity.

THE COURT: I guess I am asking do you think it would kill it because it would introduce the free rider program, because as things are now set up you are essentially forcing a contribution from everybody, thereby giving everybody an assurance others will contribute. If you have the purely voluntary [3234] situation would you not be introducing the free rider problem which applies to charitable endeavors as well as to anything else, thereby making it less likely that one person would contribute because he or she thinks that other people might not?

THE WITNESS: I think you might say that you would reintroduce a free rider problem. I think you have solved the free rider problem by giving the market value for the dollar paid, not the lowest price on the block but the market value for the dollar paid. You could reintroduce the free rider problem, but what you would then do is the person will say I will give charity with all the uncertainties usually attached to giving charity, which includes will the guy down the street also give to charity, would he be similarly motivated. If you had the choice of either the ABA offering the competitive program or the check off. Then you are right, you would reintroduce a free rider problem which you eliminated by giving the thing a value

to begin with. Don't you then put it on the same standing that almost all charities except what we give to the federal government stand on?

* * * * *

[3278] THE COURT: Let me ask the question, and I really do want you to steer clear of answers that would jeopardize settlement on the one hand and anybody's position here on the other, but the two cases, the unrelated business case plus the deduction case go down the track parallel up to a point. But they do diverge. At some point they turn out to be different cases. And the question I have was are they so tied together in everyone's mind that they must be settled in a parallel fashion, or is there some way of settling the deduction case for percentage, or the unrelated business income case and let me decide the deduction; or indeed might it be possible to give up one for the other?

What I am saying is I am not sure if the consistency of resolution is necessary then in a merit determination, and certainly not in a settlement. I mean one could very well say this is not taxable to the Endowment but not deductible to the members, or conceivably one could work some other way. I am just throwing these out as possibilities for exploration if they have not been already.

[3279] MR. THROWER: I would say in response to that, Your Honor, that whatever settlement that was made in order to preserve the viability and credibility would have to be acceptable to the members who are participating. And I think it needs to be rationalized to 55,000 or 60,000 lawyers as to what is being done, and if it were rationalized we think we could do it. However, we think an irrational, factually irrational settlement would not be accepted, and therefore we could not accept a plan for the future in settlement that could not be rationalized when explained on the facts to the lawyers that are involved, and who will be asked to continue to participate in what we say is an essentially charitable program.

MR. GREGORY: Every time he says I have got 55,000 lawyers for clients, my back hurts more.

MR. THROWER: There is the very real possibility, as has been discussed, that the members having presented to them something that is irrational would prefer simply to terminate it all together, and that I think the evidence shows that choice is available every year.

THE COURT: Well, I am certainly not an expert in handling 55,000 lawyers, clients or whatever.

* * * * *

[3375] Let me tell you the problem with Perlmutter, if I could. Mr. Thrower reminds me, there is a failure of proof there. There is just no proof there as to the value of the financial benefit on the one hand and the value of the charitable contribution on the other. What we have here is a proven tax methodology for determining the value of the insurance coverage received by the member. And the excess amount being the dual payment for charity. And that is what the Tax Court is talking about at Perlmutter. They just can't separate out from the economic transaction the value of the zoning change and the value of the property.

THE COURT: Let me see if I can get you to come to grips head on with each other. What I think Mr. Dennis argument is going to be. I will do the same thing with him. Basically coming from the transaction at a different direction, you are looking at fair market value from the perspective of the organization, saying fair market value of a product is the cost of the product plus a little bit more. So recognizing for a minute the fact that this is an association, putting that aspect aside, and maybe that is a crucial distinction, but let's put that aspect aside for a minute; what your argument would be in [3376] that other context would be if you have a grocery store and it buys a loaf of bread at retail for $1, the fair market value, the fair market retail value of that loaf of bread is $1.25, because

25 cents markup is usual in the business. Or it would be something in that perspective.

Now, Mr. Dennis, if I understand it, would go around and look at what other loaves of breads are selling for and particularly how hungry you were for that particular loaf of bread and what would happen if you walked—say somebody walked up to you in the desert with that loaf of bread, you would be willing to pay more. Assuming you are in this market he would say what happens if you try to buy this same loaf of bread at Giant other than Safeway and he would say well Giant sells the loaf of bread for $2 and therefore the fair market value of that is somewhere around $2. Whereas, you would say the fair market value is something closer to $1 or $1.25. This is what you are both saying. I am wondering if you are going to kind of come to grips with the difference in perspective and why you are looking at the transaction in a different way.

MR. GREGORY: Because the authorities cited in our brief say what you value is what you get. And [3377] on your example—I am then going to give another example when we are finished with this particular dialogue, but in your example you have got to value what is the fair market value of that loaf of bread. In that case, presumably retail sale of that loaf of bread is the fair market value. What Mr. Dennis is telling you is "no, if only—this bread is sold only in this store at a certain price and that is the price the public buys it at, that is not how you value that bread." If you can find in order to get the price up, which is what the Government is trying to do here, what you do is wander around town and look for a different product that will substitute in terms of your consumer needs and consumers desires for the loaf of bread that you can only buy in that store.

That is what the evidence in this case requires the Government to say. There is no other loaf of bread around town, in the insurance industry, in terms of the evidence in

this case. This is association group insurance, it is a specific animal and the case is dealing with the valuation of group insurance say you value that whether you can go out and replicate the purchase somewhere else or not. What you value is the cost. And I am trying to come to grips with what the Government is saying. If I [3378] miss your point—

THE COURT: Why is that? Actually I think I may have short changed the Government argument. One thing they are saying is you go around town and see what other loaves of bread are selling for. Maybe one can never find the exact same loaf of bread but we all value things by close analogy to other similar things. They may not be identical but you make adjustments for differences. The other thing it says is look—you then ask a thousand people what you would pay for this loaf of bread, what is it worth to you and they all say something like $2. You know, I have looked around they say, and that is too much money to pay but you know, I really think in my heart that I ought to be able to pay less, but it is still the best deal I can get given all the other alternatives. And Mr. Burnett was that one thousand people, or one of those one thousand, or a representative sampling supposedly of people like that who say, "Well, this is the best insurance I can get. I am somewhat overweight, I am thought to be somewhat overweight so I have trouble getting insurance and this was the best deal in town for me. So to me the fair market value was what I actually paid."

What is wrong with that analysis?

[3379] MR. GREGORY: Nothing. He probably shouldn't take a deduction.

THE COURT: He didn't.

MR. GREGORY: Well, he probably shouldn't have.

Look, Your Honor, you have of course assumed in the question you put to me the distinction that is applicable to this case in terms of the American Bar Endowment and the

American Bar Association and its ability to replicate the group. That is why I did not respond on that basis. You said put aside the fact that this association, put aside the fact that this association could get it for $1 for $2 if it chose to do so. Indeed for $2 instead.

THE COURT: No, we assume—

MR. GREGORY: Assume all the assured members participating in this plan can buy it for $1, if this group chose to do so?

THE COURT: That is right. And we have assumed that the association can get it for $1 in either case. Now, how much they charge the members or how much they require the members to pay for it, or how much they require the members to leave with them is a decision that they make—

MR. GREGORY: Except that the association is [3380] the members and the members are the association.

THE COURT: I want to get to that in a minute. I am wondering what, if this were a third party transaction—I want to focus on the associational aspects separately. What if this were a situation more like Disabled American Veterans where there were no sales to members, where the people who bought the product had only one choice; one choice, two options, and that is to buy the product at the price offered, or not buy it. And they have no control at all over the association to change its policies. What then would be the fair market value? How would you then determine the fair market value?

MR. GREGORY: Exactly like Disabled American Veterans tells you, and specifically in the discussion we just had about the decision. You have got to value that product. You have to determine under relevant tax principles—I have been very concerned in this case, that we have heard an awful lot over the weeks about economic principles, marketing principles, and very little about tax principles.

We are dealing with the Internal Revenue Code. That Code says that you value that product. And when you value that product you reach a $1 result, as they did, as the Court did on the basis of the [3381] proof in Disabled American Veterans. They determined that there was a certain fair market value to the product, in this case the retail price, because that is the kind of product it was. Then amounts in excess of the retail price, in excess of the fair market value were not either—either were not income to Disabled American Veterans, where if they did it for two reasons, when it was sold much more than the retail price, the Court dismissed part of the case by saying you are not in a competitive commercial atmosphere and therefore, no income at all.

As to the second part, they said we are not so sure about the $5 items, some are less, some may be five, some may be more, so in accordance with what at least I read in Footnote 19, the Court regarded as clearly analogous precedent, what you do is determine the value of the product in question and the charity takes in that amount as income, the value of the product in question. It doesn't take in the payment that it exacted, if you want, from the general population for sending them books, maps and charts in excess of what those books—not some other books, but those books and those charts and those maps can be bought for, what they have a retail value of, in that case the fair market value.

[3382] And we think that we have set forth in the brief by a discussion of the methodology for valuing group insurance—we are not writing on a clean slate here, we are writing by analogy to situations where an employee is given group insurance, which that employee has not got a chance in the world of replicating on the outside. You don't value the group insurance in those cases either under Section 61 or consistent with the principles of the Section

79 by hypothesizing the individual leaving the group, going down the block and trying to do his best to get $100,000 of insurance coverage. That is just not the tax law.

What you value is how much did it cost to get that group insurance. And that, I think, is precisely what we are asking the Court to do here based upon the evidence in the case. And the evidence are dollars and cents. Member paid $100, $50 came back as a premium refund, kept by the Endowment pursuant to the assignment, $10 were spent on expenses, we concede—as we have said all along that the member doesn't get a charitable deduction of 50 because the costs of running the group, and I guess including any reasonable profit if you want to say we are performing that kind of service, get deducted before the charitable contribution is figured. But he certainly [3383] gets the deduction for 40, just like the employee who cannot go out and get $100,000 of insurance anywhere else only takes in the net cost of group insurance. The net cost of the employer-employee group.

THE COURT: I guess your point is regardless of whether to him that insurance is worth more or less?

MR. GREGORY: Well, let me—I don't want to turn the tables and be asking you questions, but I am not sure I know what you mean when you say with regard to that—

THE COURT: Well, say you have an employee with a bad health situation.

MR. GREGORY: No question that has absolutely nothing to do with it. You value the group insurance as the very nature of the group, that there are some people with bad health, as Mr. Barnhart kept wanting to talk about in his objective presentation, but the 60 percent of the populous [*sic*] that gets non-smokers' rates—and we didn't have that from Mr. Barnhart until we got to cross examination. But you don't take the smokers' rates into account. You don't look at each individual member of the

group and say what could you go get insurance for on your own because he would not be getting group insurance. You wouldn't be valuing group.

* * * * *

[3457] THE COURT: No, no, no, this statement that a change to an independent insurance would not likely save you much money. I think that, at least as I interpret the statement, what Mr. Lashley is saying is if we did not run this as a charitable endeavor but we did it only for the benefit of the members you wouldn't save much money. Is that what you think he is saying?

MR. DENNIS: No.

THE COURT: What do you think?

MR. DENNIS: That if we gave the individual members an option of receiving the dividend or retrospective rate credit we wouldn't be fulfilling the functions of a section 5013 C organization, it has to be formed for the benefit of the public at large not for an individual member. And that is true of almost any of the—

THE COURT: Yes, yes, I believe you. Okay. So you say what I suggested earlier had happened, and that Mr. Murphy's request, or at Mr. Murphy's vote the plan were pulled out of the ABE, put into the ABA or some other non-C-3 type organization and from now on in rather than getting a little card in the mail saying congratulations, 40 percent of your dividend is now being contributed to charity you will get a check in [3458] the mail saying congratulations 40 percent of your dividend is hereby refunded to you in cash which you can spend to your heart's content.

Now, how can you tell me that would not save much money? 40 percent. I mean Mr. Lashley might have been saying that, but I disagree.

MR. DENNIS: Two points. What I understand Mr. Lashley to say in the letter is that "Mr. Murphy, you as an individual consumer in your position in the marketplace

you are not going to be able to save any money on any of the other—

THE COURT: No dispute on that, Mr. Dennis. Of course not. I mean the case is founded on that distinction. I mean we are not three weeks back, it is the end of the trial. There is no doubt at all that some consumers of insurance, perhaps many consumers of insurance could not independently get the benefit of the lower rates they could obtain through the ABE. That is precisely correct. Nobody disputes that.

I thought Mr. Lashley was addressing something else.

MR. DENNIS: I don't see him as saying that when he says independent insurance program. I read him as saying alternatives in the marketplace.

THE COURT: Well, in that case I beg to—I [3459] take back whatever I might have said about Mr. Lashley puffing. Of course that is true but trivial. How does that respond to the question I posed to you, which is what would happen were the ABE plan changed to be operated on a service basis. And what effect does the ability of Mr. Murphy and others to make that change have upon the consideration of this case.

MR. DENNIS: As we read the case law, Your Honor, a (c)(6) organization cannot be formed to provide benefits, low-cost insurance, to members either. That no matter what type—

THE COURT: You think that a specific answer to what I had asked is that if the ABA assembly decided to pull the plan from the ABE and run it itself, the American Bar Endowment decides to run the plan itself on entirely a service basis that that would be illegal or in contravention of the law?

MR. DENNIS: I don't know about illegal, simply they were formed for public purposes—

THE COURT: Would they lose the (c)(6) status? Isn't ABA 6?

MR. DENNIS: Yes.

THE COURT: Would they lose the (c)(6) status, would the wrath of the Lord fall upon then, would anything terrible happen?

[3460] MR. DENNIS: All I can say is there is a number of cases under (c)(6)—

THE COURT: You know or you don't know?

MR. DENNIS: I don't know. I think it would be in jeopardy.

THE COURT: What about the plan of the American Medical Association or American Psychiatric Association?

MR. DENNIS: I understand that the AMA—I don't know the facts. I have heard they are not an exempt organization. I could be mistaken but I hear they want to provide low-cost insurance.

THE COURT: How about the New York State Bar plan, does that place the New York State Bar in jeopardy of losing whatever status it has as I assume an exempt organization?

MR. DENNIS: I don't know the section they are exempt under. And I don't know the facts of their case.

THE COURT: We may not have a difference in law. At least I don't know the answer as to whether moving the plan into the ABA would place the ABA's tax status in jeopardy. I guess you are not able to tell me.

Let me ask Mr. Gregory as to whether he [3461] shares those doubts because I would like to identify any unresolved questions of law.

MR. GREGORY: Depends what you mean by doubts. There is no question in the world that the ABA could run this insurance plan as a service to members. Let me let Mr. Thrower respond.

THE COURT: I simply want to see whether there is a difference of opinion on this.

MR. GREGORY: Well, let me say that I think the tax lawyer ought to respond to that directly. Mr. Thrower just knows more about how to answer this question than I do. I would like him to answer.

THE COURT: I really wasn't looking for an answer, merely—

MR. THROWER: Well, Your Honor, I think in a nutshell if those services are incidental to its total services rather than its sole activity there would be no question about it. I think the evidence has shown that almost all of the state bars in the country do this, and many local Bar associations. And the Philadelphia Bar association.

* * * * *

[3532] THE COURT: [If you] are talking about New York and adopt Mr. Gregory's test, or if you are talking about New York and adopt your test, you really have somebody who has a clear option, much cheaper insurance, goes and buys ABA, if you really look at that person's situation—I don't want to put words in your mouth or certainly not any admissions, but I think if we sit it on the table, we say that person probably was making a contribution and the fair value of that insurance is certainly in more than getting the very same insurance from the New York State Bar and I am going to put aside the differences as to whether New York Life Insurance provided by the state Bar or by the ABA is a little bit better or little worse. I just think the distinctions are silly. I mean I have heard what they are and I don't just think they are very important.

So it seems to me that anybody in New York State who buys ABA insurance is going to be making a contribution, unless they are really misinformed, and I am not going to presume lawyers are misinformed when it comes to bucks. It is just not my usual experience.

And then we get the lawyer in Oklahoma, or Louisiana, or Podunk and it is very much more likely—or where Mr. Burnett came from, Arkansas, where it was quite clear to me he grabbed the best deal he could.

* * * * *

[3536] THE COURT: Okay, thank you very much. I am going to take a little break and come back with as much of a decision or perhaps an entire decision, as I can make today.

(A brief recess was taken.)

THE COURT: Please be seated.

I am going to decide Case Number 465-82T, the case of the American Bar Endowment versus the United States, in favor of the American Bar Endowment, the plaintiff.

I have sat through three and a half weeks of trial, and have had an ample opportunity to observe witnesses, and to absorb their testimony and I have looked at as many documents as I think could profitability [*sic*] be looked at. And the reason I am deciding that case in favor of the American Bar Endowment is that I have determined that this is not a business and is not making a profit from its enterprise.

Now, Dr. Plotkin suggested several smell [3537] tests that can be employed for that purpose, and I suppose I have used my own smell test as well as the facts.

The first factor, and one which ought not to be at all underestimated in importance, is the way the program is billed, the way it is advertised, the way it is presented, the way it is operated. The program is presented to the world and to the members in a very open fashion, as a charitable program, as a means of fundraising.

That is not determinative. The fact that the program either through subterfuge or through perhaps honest delusion is presented as a fundraising effort or the means to raise charitable funds, is not conclusive, is not binding on the Court; but I certainly think it is well worth considering as one factor.

I may be less skeptical than my brothers and sisters in the field of taxation law, but to me what people say to each other, particularly when large groups of people say it repeatedly to each other and they have a common understanding, makes a difference, makes a starting point. It raises a presumption. Perhaps not a very strong presumption, but one that I think is well worth keeping in mind as a place from [3538] which to depart.

Now, in this case we have seen a good deal of advertising and a good deal of literature, a good deal of promotional materials, ABA journal articles, reports, so on, and I find that it was made abundantly clear to the ABA membership and the ABE membership that the insurance programs were a method for fundraising. That was billed as its purpose, and this was communicated in fact to the membership; and one, of course, can never guarantee in a group of 300,000 that each and every member will unmistakably learn the precise purpose, but I find that with perhaps trivial examples, lawyers being well informed, certainly being able to read, and there was a barrage of literature, barrage of advertising, barrage of reports which over the years should have made it abundantly clear and did make it quite clear that was the billed purpose, that was the way the program was perceived.

I also look in the smell-test category, rather than necessarily the operative fact—and it is a gray area as to where one begins and the other one ends, but I also look at the startling profitability of this group. And it has made a lot of money over the years, it has made $63 million. That tells me two things. One of them is there was a lot [3539] of testimony about who else in this general type of enterprise or in this general field has made, or will make or can have made this much of a profit, and I think the evidence is quite clear, and in any case I so find that equivalent profits were only made by what has been described by one witness as the robber scoundrels of the insurance industry

who, as I understood Ms. Khachadour and other witnesses to explain, used captive audiences, used very serious pressure tactics, used practices that can viewed as entirely—or could be viewed certainly and have been viewed as unethical and have been made unlawful; such things as a person who wants to get a loan, who may be desperate for a loan, maybe something having to do with his house or who may need the loan for some other personal purpose and may be required as a condition for buying the loan to buy the insurance.

The analogy to those kinds of situations, or to that kind of an enterprise is nonexistent here. To be sure, the American Bar Endowment used advertising and something that conceivably could be viewed as scare tactics, listing the many illlnesses that befall man in light of his transgression many years ago with the apple and the snake; and I suppose that is our lot, we have frail bodies and once in a while we do get [3540] reminded of the fact that the unfortunate among us can be beset with illness and death.

But that is an entirely different kind of pressure tactic than holding the necessity of a completely collateral nature, such as a loan, car or house loan, or some other transaction, hostage to the purchase of insurance.

So when we look at the question of these great tremendous profits, we have to find some other explanation as to why this particular operation has been so successful in raising funds, and once again here I reveal my lack of skepticism, perhaps, but my feeling is that the obvious explanation sometimes is the one that is correct. You know, if it looks like a duck and quacks like a duck, and you know it leaves droppings on the floor like a duck, then maybe it is a duck. And in this case the explanation that suggests itself to the mind immediately, if indeed the American Bar Endowment were selling its members—"selling," I use loosely the term, was conveying the idea

that this was a fundraising enterprise and therefore rates are going to be set in accordance therewith, and that the many millions of dollars that were made from this enterprise were disclosed to the members over the years, and the profitability of the enterprise [3541] continued, the suggestion is that maybe members really thought this was a fundraising enterprise, that they were really participating in fundraising and that they tolerated this as consistent with the purpose of the effort.

This is certainly the suggestion that arises in one's minds when one looks at these factors. Nothing I have seen in this case suggests that that is different. I think it is almost bizarre to suggest that the strong fundraising aspect of the literature and of the approach, of the information conveyed, the fact that the profits, as they are called, or the result of all of these fundraising activities were disclosed and, so to speak, rubbed into the faces of the members, that it would be ignored, that it doesn't exist in reality? I simply have seen nothing in this case that suggests that those factors ought to be not taken into account.

Now, what have we got here? When I started to analyze it, I posed it as hypothesis at various times in the trial, but now I will state it as my finding: I think we have a situation here where there is a group asset. There is an asset that exists only by virtue of the group.

An individual member does not have a piece [3542] of the asset in the sense that he could walk away and pocket it and use it on his own. By virtue of existing as part of a group something more is created, an economic good is created which did not exist outside the group experience. And I am not sure how to characterize this asset or what I ought to call it, but we all know, all of us who have sat here and watched for the last several weeks know the nature of the beast. It is a favorable group rating. It is the ability to bargain well with the insurance company and to get the discounts that go with being an experience rated group.

It has been described in various ways, but what it amounts to is a reality that seems to be, at least as far as this record is concerned, limited to the insurance industry. I don't say some other case might not arise that might involve a similar analogous experience in some other industry, but nothing suggests itself to the mind.

The asset is created by virtue of the fact that it is possible, or so we have learned, to segregate out of the mass marketing of insurance a group that has more favorable morbidity and mortality experience; that enables that group and its members by virtue of group membership to profit from lower rates. [3543] Or they could profit from lower rates if they don't do something to stop themselves from so profiting.

And that raising [*sic*] interesting questions. I wish I had had economists to dicuss with me—because I am not sure anybody else here likes economists. I know Mr. Gregory is skeptical of them, but I for one enjoy listening to economists and I frequently learn. And what was somev hat lacking on this record, and what I had to to some extent use my own imagination for is the economics of the group asset. How does one create a group asset, how does one control a group asset, how does one monetize a group asset and the various aspects of group ownership, control and distribution of whatever benefits are involved.

And absent evidence to the contrary it seems to me that an asset that is created by virtue of the existence of the group ought to belong to the group and not to any one individual member, that it is something that the group as a whole must dispose of through normal group processes. It is not, as I said, the type of asset that could be divided up and allow each person to walk away with it, it has to be dealt with in some group fashion, left to be dissipated. It seems to me group processes normally rule by majority [3544] and when the group is too large to have absolute majority rule the representative process is the way to dispose of group assets.

To be sure there are always in the group, as there is in society, those who would deal with group problems in a fashion which is different from the majority. That is the nature of the democratic process and that is the nature of the group process. Any group larger than one has a potential for dissidence. And I don't know what one can do about it. We are all a part of groups and societies; and I dont't think there is anybody here who agrees with everything our Government does in every instance, nevertheless it is our Government and it has imputed to us our action, and by the same token the group asset is disposed of by the group. In this case the group has made a decision through its membership, or its leadership to dedicate and devote the group assets for a charitable purpose. And they have chosen a way which in my view is calculated to achieve that result. And by donating the asset in total to the American Bar Endowment and allowing for it to monetize it, to in some fashion derive from this asset the most benefit that it can for the charitable enterprise.

Now, it should be observed, and I think Dr. [3545] Plotkin agreed with me on this, from an economic standpoint the membership by making the decision has uniformly to a person made a contribution in an economic sense; by voting for this group device, for this disposition of the group asset, each and every member has been deprived of the opportunity to participate in a lower-cost insurance program, if indeed the American Bar Endowment were able to set one up.

Now, there have been some last-minute questions raised on that, and I simply cannot believe that after all of the evidence we have seen in this trial about state bars and local bars and county bars setting up group plans that there would be serious question that if the ABA membership with all of the legal talent at its disposal chose to set up a plan that would be simply a service-oriented plan that

they could not figure out some way of doing it without losing the tax status of either the ABE or ABA or both.

Now, by making the decision, each and every member is contributing to the joint enterprise by agreeing to forgo the benefits, and they have been pointed out to be substantial benefits, of the much lower service-oriented group insurance.

The question then arises to what degree is [3546] there really control over the group. By the group rather, I mean over the program. And that has been raised as an issue. And I simply have seen no evidence at all suggesting that this group is any different from any other group in the ability of members to make their views known to the leadership, and to change the direction taken by the leadership when it is inimical to their understanding and interest.

I said I would take judicial notice of the events that transpired in the D.C. Bar several years ago, and in that case there was a great rift between the leadership of the Bar and the rank and file. There is great evidence that the D.C. Bar thought that the two referendums that were posed, one which would lower dues on the one hand and the other which would limit activities to the Bar, would sound the death knell to the Bar as an institution, that it would render it merely a shadow of its former self, that it was the professional responsibility to engage in other activities, that this was generally a bad idea.

There was no doubt to those of us who are in D.C., certainly not to me when I was here when this was going on, and certainly the materials don't raise [3547] any doubt, but that this was a grass roots movement versus leadership of the Bar. And when all was said and done, and when it came down to the economic interests of the Bar members and the few dollars here and the few dollars there, and the dust settled, the members of the Bar spoke loud and clear: They preferred to keep the money themselves rather than engaging in various extraneous Bar-type activities, other

than the minimal ones of attorney discipline and the like. D.C. members simply did not want their Bar squandering their money, or at least they viewed it as squandering their money on public spirted types of activities, activities that would enhance the organization.

I have little reason to believe that when $63 million are at stake that the members of the American Bar Association or the American Bar Endowment could not change that policy. Now, again I want to point out that more than $63 million are at stake, because not only is at stake the amount that was actually collected in dividends and premium refunds, but one must also include the economic incentives and the economic benefits lost, all of the benefits that other members of the Bar who chose not to participate in insurance would have gained if only there were a [3548] change in the policy. So we are not talking only about those who buy the insurance and forgo the premiums, but we are also talking about the significant economic incentives that exist for those who do not buy the insurance but wish they could.

I am persuaded that if the American Bar Association Plan were not viewed as a fundraising enterprise and were not viewed by the overwhelming majority of the membership as something to be tolerated as, to be sure, an economic expense but one for the good of the profession, and for the greater good of society, that it would not exist, it could not have existed, it could not have survived, it would not have survived to today. And at least on the basis of this record those are my findings on that point.

I do want to speak a little about the analysis of Dr. Plotkin, whom I certainly enjoyed hearing, and for whom I have a great deal of respect. I questioned him at some length because—well, I couldn't forego the opportunity, and because I guess I had questions that went to the heart of his analysis, or to the manner in which his analysis was constructed, and I wanted to understand what direction he came from.

Now, Dr. Plotkin was quite candid that the analysis that he employed was an industrial [3549] organization analysis. It was analysis born of antitrust. Much time is spent by economists wondering whether if one fixes prices everyone will be better or worse off, and as I recall by way of showing on that board—I am sure Mr. Gregory would want to know precisely how that is done—that if you only avoid price fixing there will be more things for more people, and things get more complex from there.

The question I asked myself is how do the underpinnings of industrial organization analysis, antitrust analysis, relate to the question in this case. And the question in this case is a rather more narrow one. We are not dealing with the broad questions of antitrust, those questions involve very complex issues and very complex policy judgments. We are here dealing with basically the question of whether something is a business or is not a business, whether something is a fundraising activities or not a fundraising activity. We are looking to indices, but by definition that activity has to take place in the market.

And by definition, again from Dr. Plotkin's own statements, that activity, fundraising activity, must displace and must have a ripple effect upon the market in which it operates. It is almost [3550] inconceivable to have some activity that one could classify as simply fundraising that does not somehow effect other transactions in the market and other various structures of the marketplace. And I was interested to find out how those policies, how the things that Dr. Plotkin was taking into account in reaching his conclusion related to what we are talking about here.

I was a little disappointed to understand that Dr. Plotkin, while he was conversant with spaghetti—which is fine, which is really the place where the unrelated business income tax started from—was not as conversant as I well might have hoped with the policies of the unrelated

business income tax. To him the fact that if one buys one brand of spaghetti one is less likely to buy another one seemed to be—I don't mean to give too little weight to his testimony, but simply that seemed to be the key for him, a question of substitution in the market. And this is simply not the way I viewed the unrelated business income tax and that is not the way I viewed the Disabled American Veterans.

The unrelated business income tax was passed to avoid a certain kind of evil. Now, we all know that one cannot use and ought not use, and I certainly [3551] will not use legislative history to go contrary to the express terms of a statute when they are clearly applicable to a situation. But Congress was not so generous in defining for us business profit and the like. We have to make the decisions on our own, we the courts. And therefore in looking at a situation where you have a transaction where both buyer and seller are consenting in the sense that one controls the other, or one has significant control over the other, one is somewhat at a loss to see whether something is a profit. That is what we have been grappling with here for the last three weeks. So you go back and look at what evil there is in the market. What was Congress trying to do in 1950 or 1953 or when the uniform business income tax was passed, and one comes to the frequently-asked question, "Who is Ronzoni."

Now, nobody has really satisfactorily pointed to Ronzoni for me. I have been listening for three weeks of trial and nobody came up and said, "Here, this is Ronzoni, this is the competitor that is going to be adversely affected in the manner in which Congress feared there would be adverse effects when it slapped Mueller Macaroni Company on the wrist, or basically said you cannot do that, you cannot use your [3552] tax exempt status to make profits.

And I am still somewhat nebulous as to who Ronzoni is, as to who is hurt, who is damaged if the members of the association on the one hand allow the association to use its group asset in order to raise funds. And I don't think—you know, the most obvious Ronzonis, or the most obvious candidates are the other life insurance companies, your Prudentials, your Mutuals of New York, and the like. And all the evidence seems to be that if only ABE charged less, if only ABE charged less and perhaps charged so little as to make no return or profit or whatever one calls it, fundraising, at all, there will be more people buying ABE insurance, for many people that would then become a better deal and it would be more likely that Prudential Insurance and Mutual of New York and the like would lose business.

So in that respect the results suggested here by application of the tax at least initially looks like a perverse result. But when one thinks out loud, what else is there? I mean is there some other organization in the market, some other Ronzoni, some other enterprise that is damaged, hurt, that suffers by virtue of the fact that this charitable type enterprise in engaging in this activity. Is the evil [3553] the Congress sought to alleviate creeping in in some fashion which is not obvious to the naked eye. And it takes another look.

And the question then is what of the organization as an intermediary, or as somebody who goes and sells the group experience for insurance companies, or somehow competing perhaps with other people who would act as intermediaries to this group, or something of that sort.

And the evidence tends to strike a couple of these hypotheses out right away. All of the evidence on both sides makes it clear that the money here came from premiums, that no matter what the flow of dollars the economic reality was that these were the members paying money to the association and not insurance companies paying the group in some fashion. The evidence of the in-

surance people was clear, but more telling was the undisputed evidence of all of the other witnesses, Ms. Khachadour as I recall was one of them; and quite clearly insurance companies don't manufacture money, although some of us may suspect at times they do; it comes from premiums.

I don't think this is a terribly complicated transaction, I think most people know what dividends are and that basically they come from refund of the [3554] premium and the premium came from the member. So it is difficult to construct a hypothesis that somehow the group is selling something to the insurance companies.

And you get back to the question is the group profiting from its own members. And I simply was not able to find that it is. I find that the idea of profiting from oneself, that the idea that profit given by consent, is almost a contradiction in terms.

Now, could somebody else have stepped in, or is ABE precluding somebody from stepping in and taking advantage of some market opportunities, the sellers of macaroni, some sort of analogy of that sort?

The point is there is only one such group asset, only one group experience. It belongs to the group. I have seen no reason to think that it belongs to society as a whole or to individual members; nothing has been presented to suggest that it ought to belong to anybody but the group. And this situation is not like the purchase of macaroni, where basically only one entity can have the benefit of that and the group has chosen to make a gift of that group asset to the Endowment. And you know, perhaps other witnesses and other economists, on a different record, somebody will be able to point out to me Ronzoni in this [3555] picture, but I have tried very hard, and looking at the policies of the tax, the policies of the unrelated business income tax, I have not been able to find the evils that Congress sought to alleviate by passing that tax.

Therefore getting back to the analysis itself, there is nothing that would push back the original inclination I had, this is billed as a charitable enterprise, it is presented as a charitable enterprise, it is a group asset, it is given by mutual consent, members have control, one can't make a profit on oneself, I don't think. I think it is the antithesis of a profit to say that one can have control of how much profit we take, much like the suggestion I made to Mr. Dennis what would happen if all Safeway customers were allowed to vote on the prices at Safeway. The reason Safeway makes a profit is because customers don't get a chance to vote. And I therefore conclude that it is just not a business enterprise, by its structure, by the way it is operated, by the way it is billed and by the reference to the policies of the tax, there was not profit and therefore not a business.

I have considerably greater trouble on the issue of the individual members, and as clear in my [3556] mind as the issue of the Endowment is, or at least the way it seems to me it is clear, I have still grave doubts on the question of the individual members, and I am not going to be able to resolve them today.

I have listened to both sides, I have listened to both sides speak today, and perhaps the problem is the case has been tried and presented and certainly viewed by me largely with reference to the unrelated business income tax, to that aspect of the transaction, and in the fond hope that that would take care of the other problem as well. And in Plaintiff's view I know that it does. In Defendant's view I think, had the result been different on the Endowment case, I am sure they would have had the same view. I view them as not necessarily related. I recognize that is a much more difficult problem and one that I just cannot resolve today. I am simply going to have to go back and think about it.

I understand very well where the two parties are coming from. I think I understand this case as well as anybody here, because I have the benefit of not having the perspective of one party or another. And Plaintiff is saying the valuation of insurance to a group ought to be the net cost. That is a fair market value.

[3557] I understand Defendant's position equally well, that one looks at comparable sales and comparable transactions and that you don't look at cost of the product to determine its value. One can get into a bargain and buy something one day, buy a stock one day, say, and then it gets taken over, or there is an offering by some other company to buy out that stock and it immediately shoots up. Well, the fair market value of the stock is not necessarily what one paid for it the day before, it is what somebody else was willing to buy it for today. Those who have bought and sold on the stock market know that. I think there are inherent and difficult inconsistencies that cannot be resolved by either position and that may be unresolvable.

I recognize that the Government has done away with, or has never really quite presented the Duberstein test; and the question is not one of good heart or generosity, but I am troubled by the position taken by the Plaintiff in offering Mr. Burnett a charitable contribution. I may decide that nevertheless Mr. Burnett ought to get one, but having seen him sitting on the stand, and being convinced that he in fact bought the insurance because it was the best deal he had, I am troubled about saying that [3558] he ought to get a charitable deduction on top of everything. I simply am convinced as to him that he is buying the insurance by virtue of the fact that it is the best deal and not because he has any attachment to the Endowment's purposes or otherwise.

I am equally troubled by the position taken by the Defendant, the suggestion that these are name tags, or books or key chains capable of valuation in one market is

simply not supported by this record. I think it is utter nonsense. I think there are at least 50 markets for insurance, particularly group insurance. I think one ought to take into account the basic and significant differences between group insurance and individual insurance. I think individual insurance by clearly established record is a different product, and a significantly different product. One can take it with one to one's grave or something of that sort. Certainly to California. And it is viewed, soid, marketed and considered as a different product. There are little frills you can buy with it. You can buy double indemnity and accidental death, waiver of premium; you can insure your insurability. It is yours, you can do lots of things with it. I think the subjective valuation that people place on having an insurance plan is not [3559] dominant upon a membership to an organization or that it is somehow geographically limited.

So comparison with individual insurance, although not entirely irrelevant, I think is inherently misleading, and it is very difficult to account for the subjective differences that a particular consumer of insurance would feel in having his own insurance that can't be taken away from him, that has guaranteed premiums as opposed to another insurance where he has to pay membership in an organization that may or may not exist, that may or may not expel him, that may or may not be acting in his best interest, that may or may not be in the same geographic area all the time; let's say he has to move overseas or elsewhere, there are many uncertainties connected with group insurance which are simply not present to individual insurance and I find the analogy on them on the basis of this records [*sic*] to be a difficult one. I don't find them incompatible, entirely irrelevant, but on the spectrum of things individual insurance is much further away from center than let's say other Bar plans or other associational insurance available.

Nevertheless the point is well taken. The market consists of lots of competing products and many [3560] of them are only imperfect substitutes for another, and yet for better or worse courts must consistently make decisions on the basis of somewhat arbitrary distinctions between valuations of one item or another; the house near the end of the block as opposed to the one in the middle of the block, the house two blocks away closer to the supermarket and across the street from the school. Courts do it all the time.

What is troubling about Defendants [*sic*] analysis is not the idea that one ought to value some very, very subjective considerations one against the other, but the idea that there is one market, and the idea that one can find a fair market value for insurance in the United States and place the American Bar Endowment plan either within or without that market range. And that is very troubling.

I am troubled by the gentleman or lady in New York City who is a member of those two associations and who has by hypothesis in front of himself or herself the two plans, the New York State plan and the American Bar Association Plan. I cannot on the basis of this record—I could not conclude for such individual if he or she were to come to ask for a refund in this Court and I would look at that person's situation that a decision to buy American Bar [3561] Endowment insurance is other than a gift, that it was a contribution, that it was indeed the differential was paid in order not to get insurance, but in order to get whatever satisfaction one gets from contributing.

There are the two positions. Both create unfairnesses and both create what I view as inconsistencies. And I know both sides feel that their view of the transaction is the only one that is acceptable. I am simply saying I am enough troubled about it that I am not going to decide today. And I am going it say this much: I am not simply withholding this issue, but I am indeed undecided. I am so close to 50-50 on t issue that I cannot personally myself

tell which way I would decide the case were I to make a decision at this minute. I would probably have to throw up a coin or something close to that. I don't know if that is any help to anybody. It is not nearly as much help as getting the case decided in one's favor, but there it is.

I am fairly firm, quite firm on the Endowment side of the case. As I have said before, I consider myself infallible although not irreversible, so I think everybody should have the hope, or the appropriate amount of skepticism. [3562] I want to suggest to the parties further possibilities of settlement. I had hinted at this before today's session. I want to now propose it outright. On the one hand, I think there are basics for settling. Nobody really knows, including myself, how I am going to come out on the members. At least Mr. Rubloff empathizes with my dilemma and I hope others too. I will decide it, one way or another I will come out with it, and if nobody suggests the middle way I will have to select one of the two positions suggested, and in light of my ruling on the other case I am going to have to go back and rethink and look at the authorities cited one more time. And I figured the first case out and I will figure this one out too for better or worse, but let me suggest the possibility that settlement may not still be beyond reach.

I have made my statement on the Endowment's case. And one should not underestimate the deference that an Appellate Court will give to a trial Judge who has sat here for three and a half weeks and looked at the witnesses and considered the evidence.

On the other hand, these are big issues. And by everybody's analysis there is really not that much in dispute. If the parties after all of this [3563] want to sit down and hammer out a stipulation, I bet you it could be done. So nobody is really going to offer me the kind of deference in a case where there are two inconsistent

witnesses, one says I was home with my mother and the other says I saw them stabbing the victim. It is just not that kind of case.

I will endeavor as best I can to pull together the relevant facts as I see them, but my opinions tend to be short on facts. I tend to say only the things that I consider relevant or crucial to my decision, and I think it is fair to say that the Appellate Court will be able to make up its own mind on the analysis, the analytical portion of my conclusion. So whereas I think there is good reason for the Bar Endowment and its members insofar as the Endowment to be heartened by my decision, there is always the possibility of reversal, and I guess I don't need to repeat that again. I think it ought to be on everybody's mind.

And then there is the question of how I am going to come out on the individual members. I have no way of knowing what is really important to the parties and what is really the telling aspects of the case, whether the members' case is more important than the Endowment case or the like. This is only [3564] something that each side can determine on its own.

But as far as the Government is concerned, I promise at least as far as the Endowment is concerned, and certainly whatever I do with the members, I will write an opinion that I hope is persuasive. I will, having once decided how the case ought to appear, I will draft it in such a manner as to maximize the chances for affirmance. Let me just say there is certainly solace to be taken from the possibility of reversal, but I wouldn't count on it. I think more likely than not appellate courts in such cases tend to give some deference.

I am going to think about this case. I have about seven trials coming up, five before the first of the year, a couple more in January, and I have three major opinions in the works. Frankly, I have spent enough time on tax for a while, and particularly on the American Bar Endowment.

I am going to another trial starting Tuesday. I have got speaking engagements and trials in Houston and Lord knows. I have got a trial starting between Christmas and New Year's. So I would just as soon not think about this case for a while. And in light of all that you have learned today, and perhaps for the first time you have now had your respective views scrutinized by somebody [3565] I hope you understand understands what you all have to say. You may not all agree with everything I said, in fact I am sure each side disagrees with some of what I said, but I do understand your case and I do in light of the maximum amount of evidence that has been presented I think have a pretty good grasp of what went on.

So try to step back from your own position, from your own view of the case and kind of view it from my perspective, and then ask yourself is there a basis for trying to work out on the one hand securing the gains already made, and on the other hand salvaging the limiting losses that might already have been suffered.

So I think you should all go home, digest it, buy the record, buy a transcript, listen carefully to what I was saying, what I was asking, what I said this afternoon, and try to figure out how I am going to decide the other aspect of the case. And if you can, you are more clairvoyant than I am. But what I propose to do is take a little while off and work on some other cases. I simply do not at this point have the time to devote further to this case and I am going to leave it in abeyance. The other cases are lined up. And I do want to give everybody a chance to have [3566] things sink in and I would then like to request one more massive and good faith effort at settlement.

What I have said today on the record is not necessarily of precedential value. My thoughts are in the transcript. They do not embody an opinion. They are known to those present, but of course they would not be binding on anybody else. Think of the consequences of an opinion,

the consequences of affirmance or reversal of the opinion, and think about the one outstanding issue; and do not minimize how difficult an issue it is. Much as everybody thinks that they are right on it, I think you fairly ought to know I am not doing this in order to in a sense extort a settlement. If I could have decided the case in its entirety today I would be entirely pleased to do so. I am not holding back just to press settlement. I simply cannot decide it today. It is unusual for me, but I always reserve that prerogative, and when important cases come along and difficult issues, issues I cannot resolve on the spot, I want to be as candid about that as I am about telling you when I have made up my mind.

Why don't we set the case for status in about three weeks?

MR. GREGORY: I take it, Your Honor, that [3567] with four remaining cases of the individuals, you are not deciding either the New York Plaintiff cases today or the other cases?

THE COURT: I am deciding the Bar Endowment case. I am not deciding any of the individual cases. Now, in a sense there is no decision today, and there is no opinion or judgment or order or anything of that sort. I have simply made the prediction of what my opinion is going to read like. I am not going to change my mind. My mind may be changed for me but I am not going to change my mind on that one. In a sense what I was telling you is what my mind looks like at this point and I have decided in my mind the Bar Endowment case, and I will eventually have an opinion that reflects many of the thoughts I gave today orally.

I am not deciding any of the individual cases. I don't think they can be separated, Georgia, New York, though perhaps it can be, perhaps what we wind up with is some geographical nightmare where people from New York are going to be better off than people from Arkansas. I would

hope that is not the result I come up with. I would hope fervently that everybody thinks about the mischief that judges can do when they start trying to work their way out of what [3568] they consider to be difficult theoretical boxes, or difficult dilemmas.

I want to be candid, this is a dilemma for me. I find that aspect of the case the most difficult part. Everything else, judgment calls, whatever, but it finally fell into place for me. I see my way clear quite well on the Endowment. It just has not fallen into place for me as far as the members are concerned. Please don't make me make any mischief. We want the law to develop in a reasonable fashion. And consider your respective interest, consider what you think you can give up, take into account what I have said and the consequences of the ruling in this case to yourselves, to the law as a whole, to other taxpayers.

It is never too late to settle. I suppose it is too late to settle once cert is denied, but should we set—can I get the agreement of both sides you will go back, digest what I have said and make one final very serious stab at settlement?

MR. THROWER: Your Honor, I can assure you we will take seriously and to heart the remarks that you have made. We will make an earnest effort in the light of what has been said here this afternoon. I do know that time is required on the other side to absorb and reflect and react.

* * * * *

[3581] As usual, if you get lawyers involved performing tasks it costs them money. We made a submission. If I understand the present position, and I want to make it clear on the record, because if this case is to have a future history I know the Board will be concerned about it.

Apparently the position of the Government is that we would be free, as Mr. Thrower put it, to continue to put in offers of settlement more and more liberal until one is accepted. It would be our position, if that is the Government's position, that we would have to advise the client that that would not be a fruitful way of going, and that on that basis I would concur in the Court's statement that the parties would agree that there fruitful possibility of settlement [*sic*].

That concurrence is specifically founded upon what I hear to be the suggestion of The United States, namely, that we can keep putting in offers and we're not going to get any counter-offers.

THE COURT: So be it. I will just decide the case. Now, I'm not going to have the judgment for you until well into February. In light of what my findings and my tentative conclusions are the sides can do—you know, I'm disappointed in the fact that there has been no settlement, but I have no doubt that much thought has been given, and that without knowing anything about the settlement—and I assure you, Judge Margolis [3582] has been very circumspect, has told me nothing at all about the settlement—assuming, because I know counsel from the case and otherwise that it has been in good faith on all sides.

I guess there wouldn't be any call for judges if all the litigants could agree with each other as to how they come out.

Very well. I found this to be,—first of all, I have good news and bad news. It depends on which side. I have given more thought about the part of the case, the American Bar Endowment part of the case, the part that I had decided at the time of the last meeting, and I am pleased to say I haven't changed my mind.

I feel entirely comfortable with the result, and I can tell you now with a fair degree of certainty that that is how it will, in fact, come out in my opinion. I have not started working on the opinion, but once in awhile one makes an oral ruling and is troubled by it, and looks for ways of stepping back or anything of that sort, so I will not be stepping back from what I said the last time we met.

I may be wrong, but I am happily so. I hope I'm right. I do continue in my conclusion that—

MR. RUBLOFF: Your Honor, could I inquire of the Court as to whether any findings of fact, specific findings of fact will be made?

THE COURT: Probably not. You can pick them out of [3583] what I said in my opinion. I don't think I will make specific findings. Is there something specific you would like to ask me?

MR. RUBLOFF: Well, I know in other cases it has been the Court's practice to respond to—

THE COURT: To the written questions?

MR. RUBLOFF: To the questions that were specified by the parties as representing the issues in fact.

THE COURT: I looked at this case, and it got so involved and so far from what it was that I actually saw was relevant to the case that I decided not to go down the list of everything. I just didn't think they were all that important. But if you have something that you would like to call my attention to that you think is really important that I have not resolved, by all means call it to my attention.

I may get a copy of the order and go down with all of you when this is done. I was going to do it, and after four weeks of trial things got so, in my mind, so far afield from some of the thing that were in that order specified as issues in dispute that I decided not to do anything with it.

Let me go through and deal with each case, and then we can go back and answer specific questions. Was there anything in particular that you had in mind?

MR. RUBLOFF: No, Your Honor, I didn't mean to make any proposal or request, it was simply an inquiry because I was [3584] aware of the fact that in prior cases it had been your practice to respond specifically to the matters contained in, I think it is what you call the order governing—

THE COURT: Proceedings at trial.

MR. RUBLOFF: Right. I just wanted to clarify what the Court's—

THE COURT: Sometimes I do and sometimes I don't, depending on whether I think it is important, depending on whether the parties think is important. I look at it, and I did look at it before the last time I met with you to see whether following down that pathway would prove fruitful, and given the fact that the case was tried by one side geared to DAV to some extent, and somewhat differently by the other side, and since I decided DAV was not really relevant and controlling in this case, because in DAV there was a commercial transaction, you know, the buyers were not related parties, and here there was a difference in that element.

I may go back, let me get a copy of the order and then I may go back and answer some of your questions. Of course there will always be time in remand to answer some of those questions, too, and there will be remand.

In any case, the question of the four individual Plaintiffs, in a way I found was the most troubling aspect of the case, some of them because the way the case was tried by both sides much of the focus was directed on the Endowment case [3585] itself. To some extent there is value in that, because if I understand things correctly, had the Endowment lost that would pretty much have taken care of the individual Plaintiffs. Given that the Endowment has won makes it, I think, a much more difficult case to deal with individual plaintiffs.

And I, you know, had some misgivings, some of which I expressed the last time, about the perception that was conveyed, at least by some of the witnesses, that somehow there was one unitary market for insurance, In fact, it is quite clear there were many markets for insurance, geographically and otherwise. Certainly geographically there were large differences, and I was troubled by the possibility that some—and I still am—that some members of the American Bar Endowment who buy insurance may

be getting a terribly good deal, and may get a charitable deduction, when in fact, this is the best deal they could get.

And I was equally troubled that a blanket rule going the other way would perhaps deprive some people who are in fact making a contribution from deduction. But then I thought about it some more and decided it is really my province to decide cases and I will leave policy to people who are paid to set policy, and I can only decide the cases that are before me, and let future cases, future lawyers, future judges, those involved in the administration of justice and the administration of income tax laws and federal regulations deal with questions of [3586] equity and equality and what not.

So I went to each individual plaintiff, and I looked to see what there was in the file or what was in the record that would support his claim for a charitable contribution. And in trying to analyze the evidence I considered the dual payment cases, the cases that talk about making a charitable contribution while paying for something else, and I also considered the authority cited by the United States Government, and the conclusion I came to was that there must be some showing that the payment made had at least in part a charitable component.

That there must be showing that he was not entirely motivated by some other collateral economic concern. If the record did not establish that, the existence of some charitable component, I decided that that plaintiff should not prevail.

In the case of insurance the question was did somebody buy more expensive insurance than he or she, I guess he in this case, could have gotten by—did he buy American Bar Endowment insurance, which was a much worse deal or significantly worse deal than what would have been available elsewhere in the market. And I took each of the plaintiffs in order and looked at the status and what else

was in the record, and in the case of Mr. Broadfoot I decided that he did not make such a showing, and I am holding, in his case, in favor of the Defendant.

[3587] Mr. Broadfoot, if I did not get my names confused, I believe was one of the gentlemen who lived in Georgia. He had ABE life insurance in the amount of $50,000, and he said that he was aware at the time he made the application, or the time he paid the check, he was aware of the fact that a portion of this payment would be used, albeit collaterally when it comes back as a dividend, but would be used to support a tax exempt charitable type of activity.

But that is not enough, at least in my reading of the law. Simply knowing that part of a payment goes to a charitable endeavor does not, in my view, render this payment charitable if in fact the payment was entirely motivated, could have entirely been motivated by other economic concerns.

So it is perfectly consistent for somebody in Mr. Broadfoot's position to have no sympathy at all for the American Bar Endowment, although I am certain that he, in fact, did, or else he wouldn't have been here—it would have been perfectly consistent to know that a portion of the payment were going to those types of activities, and yet paid grudgingly. Pay it, but not be particularly happy about it, or not have that motivation at all, and we had at least one witness who said as much.

He said he was not upset about the fact that the things were going to the ABE, but that was not a motivating factor at all. I found nothing in Mr. Broadfoot's testimony to [3588] suggest that the charitable contribution was, in fact, motivating him to buy the insurance from the ABE. It is curious with all these plaintiffs what they did not say, given that they were on the stand and able to testify.

They did not say that they selected this insurance over cheaper available coverage that they had, or equal coverage. Certainly, Mr. Broadfoot did not. He made no

indication that he didn't—and not only that, it is enough that he didn't look for the insurance, perhaps because he was so enamored with the idea of contributing to the ABE. Really, nothing at all that would support the view that he, in fact, bought the ABE insurance at some economic cost to him, at some additional economic cost to him, in order to support American Bar Endowment.

If one looks at the Georgia life plan, and I have said already on this record I find that, Georgia Bar Association plan, and I already said on this record that I find the individual insurance to be materially different from association type of insurance, and I continue to adhere to that view. I believe that individual insurance, because of the differences in portability, the differences in the ability to get it with or without medical examination, is a different product.

In group insurance, where everybody in the group can get it, it may be limited to in some way geographically, it may be tied to payment of some collateral membership fee, like one [3589] has to be a member of the ABA in order to be able to buy the ABE insurance, I find them to be significantly different commodities. So I look at what might have been available to Mr. Broadfoot in Georgia, and the inference is that—well, certainly there was no evidence that he, in fact, considered any other plan, but in fact, the rates were not considerably different between the Georgia plan and the ABE plan, if I remember the figures correctly.

The question of Mr. Broadfoot, as to whether he considered the ABE plan to be outrageously overpriced at the time he bought it, he said he did not, and really, there was no indication at all, certainly not enough of an indication to persuade me that he, in fact, rejected the cheaper available coverage because he felt he wanted to buy the more expensive coverage in order to contribute to the ABE.

So in the case of Mr. Broadfoot I decide in favor—in fact, now that I look I see that Mr. Broadfoot noted that the cost of the Georgia program, in fact, exceeded the cost of the ABE, the Georgia Bar plan exceeded the cost of the ABE coverage. In light of all of that, I simply cannot find that he was making a charitable contribution.

Mr. Turner. Well, let's take Mr. Boynton, who was the other gentlemen who was in New York—I'm sorry, in Georgia. Mr. Boynton had a separate issue involving the Ionosphere Club. That issue was resolved in his favor when the Government [3590] proceeded and had put no evidence contrary to his testimony in any case, so on that issue Mr. Boynton wins. Mr. Boynton, if my notes are correct here, was involved in the diability [*sic*] program rather than the life program of the ABE. Again, he noted that he was aware that part of his payment of the premium reflected a payment towards the American Bar Endowment's charitable activities.

There was, however, no indication as to what other coverage might have been available to him. He did say he did look at other available plans. He did not say that those were significantly less expensive, and then he bought American Bar Endowment plan at some additional economic sacrifice to him in order to make a charitable contribution.

As far as this record reflects Mr. Boynton, too, seems to have gotten—at least there is nothing in the record that suggests other than that Mr. Boynton took the best deal he could get on the market. In that case, I found the motivation for purchasing insurance was entirely economic, and that his entire motivation is covered by economic interest, and cannot be deemed, any portion of it can be deemed to be charitable.

Mr. Turner. He is from New York. The interesting point in his testimony is that he says he is not a member of the New York State Bar Association. I must have been

under a misapprehension of fact at some point in the proceedings, because [3591] I did not recall this, and I had thought that New York like some other states must have an integrated bar, and that being an attorney in New York State would make one automatically a member of the New York State Bar Association. Of course, that is not true in all states, and apparently Mr. Turner's testimony is that that is not true in the State of New York.

I surmise from this that the New York State Bar Association is a voluntary association. It is a voluntary association of which Mr. Turner is not a member, or was not a member at the time he testified, and I don't think he was a member—I can't tell from his testimony, he says he was formerly a member, it is not clear when, but I gathered from what was said that he was not a member in the tax years in question.

I find Mr. Turner's case just a little bit more difficult because apparently he had had some other insurance, and it is not entirely clear why he switched. It certainly would be consistent to say he might have switched to the ABE plan because he wanted to make a charitable contribution, and he might have switched from a less expensive to a more expensive plan, but he doesn't say that.

He said that he had policies with Provident Mutual and Drexel Life Insurance, it would have been easy for him to say that those plans or establishing those plans were cheaper, and he was doing what would be counter-intuitive moving to a more expensive plan from a cheaper one, or give some other [3591-A] indication that, in fact, he chose ABE other than for the fact it was the best deal in the market. The burden is on the plaintiff. It was not established in the case of Mr. Turner.

I note that he was not a member of the New York State Bar Association, so he could not have taken advantage of the favorable rates available under that plan from New York Life Insurance Company. Those rates, from what

the evidence shows, were more favorable, at least for some age brackets. It is not clear to me why Mr. Turner was not a member, what the cost of membership would have been, what other implication there would have been for this membership, so it is certainly impossible to tell whether—on this fact, as to whether whatever cost would have been associated with becoming a member or obtaining membership in the New York State Bar Association, when added to the premium he would have paid for the insurance would, in fact, have made the New York State Bar insurance, where would that be in relation to the ABE.

There is no other evidence on the record that I could see relevant which would suggest other than an entirely economic motive on Mr. Turner's part. Again, the fact that the knew that part of his premium was going to these charitable endeavors of the ABE is not sufficient, at least in my view of the law.

The most interesting and difficult case involved Mr. Sherwood, and again I just decided these one case at a time, and [3592] I suppose with 50,000 or 75,000 members of the ABE might come trotting in here, I don't know what to say. These are the cases I have before me.

I note, first of all, that he had both life and dependent insurance. As to the dependent insurance, I—again, this is a voluminous record and I did not go hunting through it at great length, but as far as I can tell there was really nothing in the record to show comparison of rates available for the dependent insurance. There was no indication affirmatively from Mr. Sherwood that he bought dependent insurance at great economic, or a greater economic sacrifice to himself in order to benefit the ABE.

So as far as the dependent insurance is concerned, I find in favor of Defendant and against the taxpayer.

Now, on the life insurance, what makes this case interesting is that Mr. Sherwood was a member of the New York Bar Association. According to his application for

ABE insurance Mr. Sherwood was born in 1939. This is Exhibit No. 353 in the record, and I have no reason to doubt its accuracy. So that means that in 1979 he reached his 40th birthday, in 1980 he would have reached his 41st birthday—in 1980 he would have been 41, in 1981 he would have been 42.

So we have here an individual who was, in fact, eligible for the New York Bar plan, and for whom in the age bracket of 40 to 44, which he would have been in at least for the most [3593] part of those three years, the New York plan would have been somewhat cheaper for the first year, and significantly cheaper for the second or additional years. Apparently the New York plan, there was a high premium in the first year.

So that posed an interesting question, whether the availability of this plan alone, the availability of what I consider to be an equivalent product in the market, in that particular market, would have been a sufficient indication that another product was considered, was rejected, and therefore, the inference ought to be drawn that the taxpayer was choosing a more expensive and less advantageous economic product, and therefore, was doing so for charitable purposes.

That case gave me trouble. It also gave me trouble on—Mr. Sherwood's case also gave me trouble on another count. He had $320,000 worth of insurance, with $20,000 of that apparently being with the American Bar Association, and $320,000 is a fairly odd amount, so there is somewhat of an inference that he bought $300,000 insurance somewhere, and then maybe $20,000 from the ABA or the ABE.

Unfortunately, he really didn't say anything of that sort. I looked, and tried to find some indication as to what was going on in his mind when he bought or obtained the insurance. Apparently he bought the insurance in the early '70s and then raised the coverage from $8,000 to $20,000

in 1978. He does state that he was aware that a portion of the payment that [3594] he made to the Endowment was for, or would go for charitable purposes. But nowhere does he really say that he could have gotten the extra $20,000 of insurance more cheaply from his insurance company, or indeed, from the New York Bar Association, and that he rejected those in order to make a contribution.

In fact, apparently he was a member of the New York Bar life insurance program, and rejected that, let the coverage lapse later. It is not explained as to why he did that.

It is a close case in my mind. In order to have Plaintiff prevail, at least in my mind, it would have to be established that, in fact, an equivalent product was available in the market at a significantly lower cost, and I think in this case that was established.

I think it must also be established that the product was known to the taxpayer, and that an affirmative decision was made to reject the lower priced product, and that affirmative decision was based on some desire to make a charitable contribution, and although I find this case close, I decided against the taxpayer and in favor of the Defendant.

There are things that Mr. Sherwood could have said that he did not about his decision to reject or discontinue his coverage under the New York State Bar plan, there were things he could have said as to what the expense would have been of buying an additional $20,000 of insurance privately, if indeed, that was available, which I assume that it was.

[3595] Finally, although I don't think there is anything wrong with this, I think some weight has to be given to the fact that American Bar Endowment insurance was marketed aggressively, and with many indications in the literature that this was a good deal, and a good buy, and I don't mean to suggest that there is anything at all wrong with that.

Given what I have said, the nature of Endowment's endeavor was, and that was that it was a contribution, it was not a business. It was a way for the members to make this economic good available as a group for conducting charitable purposes. I think it was incumbent upon those running the Endowment to try to run it in a way which would maximize, I guess one would call the revenues, or maximize the benefit to the Endowment from this nice advantage that was provided by the members.

So I think there is nothing wrong at all with advertising that is aggressive, and in some ways suggested this may be the best deal in the market, and indeed, for many people, from the best I can tell, across the country it may very well have been a very good deal, indeed, and perhaps the best deal. It may, in fact, not have been, and I'm not sure that they ever claimed for it to be the best deal in all circumstances, but I think there was enough in the literature where if Mr. Sherwood did not have the two plans side by side, and could not see the exact rates for his particular age group, he might not be aware [3596] of the fact that he could have gotten an extra $20,000 of insurance from the New York Bar Association for perhaps less than he could have with the ABE.

I think it is a leap of faith which is one I'm not going to take without benefit of testimony from the Plaintiff. If Plaintiff wishes to tell me that he has considered a lower cost alternative, rejected it because he wanted to make a contribution, that may very well be a differenct case. In fact, in my view of the law I would, again depending on the facts of the case, probably rule in favor of the Plaintiff if such a showing were made. But a showing must be made by the Plaintiff, and I found in the case of all four Plaintiffs that the showing was simply not made.

Now, I understand why the showing might not have been made. These are test cases, and I suppose a broader victory is always better than a narrow one, a victory

where—I am just surmising, just assuming this is what might have happened—that if less is served that is fact specific, and these plaintiffs survive that would, of course, be of much greater precedential value one way or the other, in resolving what is a knotty, knotty legal issue and will affect the conduct of the Endowment and the collection of revenue laws for many years in respect to many people.

I wish I could have come up with a more creative and less fact specific decision in these cases, but from my reading [3597] of the law I simply can't. I will not exclude the possibility that under the right set of fact [*sic*] the Plaintiff could show that the purchase of insurance had a charitable component, and in fact, was motivated by more than economic desire to buy insurance. I think the authorities compel that. But on the other hand, I cannot say that once it is established some of those dollars go to charity under any and all circumstances, a portion of the payment was charitable, without assistance from above—just one or two floors above—I don't think I can take either of those positions.

Now, Appellate Courts and Members of Congress and those in the Internal Revenue Service have to look at the broader picture, or may have to look at the broader picture. My responsibility is to decide the cases I have here, and that is where I come down.

So after a truly careful review of the situation of the four plaintiffs, and I have given it considerable thought, I find that the required showing was not made for any of them, except for the one Ionosphere matter which we can put aside, and that I will rule in favor of the Defendant.

Now, do I have my order governing proceedings at trial? Do you have a copy? Is there something in particular you want to ask me? I have copies here you can look at. Someone made some notes, and you know, I don't remember why. I don't think it was me, probably

somebody else. I mean, there are little [3598] yeses and nos and whatever, it might have been a law clerk. I'm willing to let you look, and don't take whatever is there in terms of notes as a—I don't know what the notes are, so just ignore them.

As you go through, I will answer any questions that you think are not clear by now, or that—just take your time and go through it, and I will be happy to answer them. I will also use this in writing an opinion, to make sure I cover whatever points I cover or need to be covered.

If you want, I can go through and answer what I can answer. I mean, some of them seem fairly easy, some of them seem complicated and pointless. I don't mind going through and trying to answer.

Maybe we should just go down the list one time and see what we have.

On page 3, Paragraph V, Issues in Dispute.

"The parties agree that the ultimate questions of fact and law in this case are:

a. As to the individual plaintiffs, did they make charitable contributions to the Endowment during the taxable years by virtue of the Endowment's receipt of dividends and experience credits and, if so, in what amount?"

I think I answered that question. It is, as to each individual plaintiff, that they did not.

"b. As to the Endowment, did it have unrelated [3599] business taxable income arising from its receipt of dividends and experience credits during the taxable years and, if so, how much?"

I have answered that question as no, it did not have unrelated business income.

Now we get to the difficult questions, okay?

"Subsidiary Questions, A. 1. Did the individual plaintiffs, in making their premium contributions to the Endowment, make "dual payments" part as a contribution of

dividends and experience credits to the Endowment for charitable uses in the field of law, and part for insurance coverage?"

That is a very difficult question to answer. It is quite clear that the payments that they actually made were, in fact, partially used to buy insurance, and partially by way of the dividends then used to support the charitable purposes of the Endowment. I'm not sure whether anything more is implied in the question in the concept of dual payments.

Does either side wish to speak to that?

I have said that that does not necessarily apply to a charitable contribution. I do recognize that part of each, and I do find that part of each check paid, at least with these individual plaintiffs, that each check contained—well, that each check was used in part to pay for insurance, and in part eventually through dividends to pay for the Endowment's charitable purposes. Is that satisfactory or clear?

[3600] MR. THROWER: May I make a brief comment on that Your Honor?

THE COURT: Of course, Mr. Thrower.

MR. THROWER: But I haven't seen in your comments or heard in your comments a reflection or comment on our position that the group, by a group decision, has been making a group gift, that it could by a group decision change that in any year, and that where the group participates in the group decision in making a contribution equal to the difference between what they pay and what they could have paid had they made the decision to get the full economic benefit for themselves, that that constitutes the measure of the group gift, and the allocation of it made on an objective basis, and rather than on a subjective basis, would follow what we have done, what the Endowment has done, and what is customarily done under Section 61 and under Section 79.

THE COURT: Well, I accept that theory, and to my mind it brings one so far as to say this is not a business, and therefore, Endowment is not subject to a regular business income tax.

The problem is that by that argument every member of the Endowment makes a contribution, whether they buy insurance or they don't buy insurance. That those who do not buy insurance from the Endowment are nevertheless making the contribution, and that is the economic opportunity of buying—that they forgo [3601] in having the much cheaper insurance available to them, causing them perhaps to go out and buy—

MR. THROWER: That is certainly true. They make a sacrifice, each member of the American Bar Association, and thereby a member of the Endowment. Each member who does not have the insurance makes the sacrifice. Only the insured members actually pay money which constitutes what we assert is a charitable deduction.

So the sacrifice of the others is essential in order to permit the ongoing progam, but it is only the insured members who paid the money, and that entire group of people, whether they are high risk—they might be quite high risk, they might be quite low risk—nevertheless, as a group have the opportunity of getting the insurance at the low cost without any charitable element written into it.

This was the concept that we undertook to reflect, rather than the subjective approach of looking at each member, which I don't think was really advocated by either party, and as we indicate I believe in the earlier filings, it has generally been disapproved both by the Courts and by rulings of the Internal Revenue Service in favor of the objective approach, as is followed under Section 61 and 79, where—

THE COURT: Well, Section 79 is a specific statutory provision, which is a problem—

MR. THROWER: It is specific, simply reflecting this [3602] general principle, however.

THE COURT:—that Congress has addressed.

MR. THROWER: That's right.

THE COURT: I am just not able, Mr. Thrower, to—perhaps a case by case approach is not appropriate, and in that case, I simply would rule for the Defendant. I view the question of whether something is a business as something that can be made as a group decision. I don't view the question of whether one makes a charitable contribution as a group decision. That is an individual decision, and the majority of the members of the Endowment cannot make that for the minority.

They can certainly keep them from getting an economic benefit by making a group decision as to what the rates are going to be, but the idea of being forced to make a gift goes contrary to my conception of what a charitable contribution is. I remember Mr.—I don't know why I always forget his name, he was the gentlemen with the cane—

MR. WATKINS: Mr. Burnett, Your Honor.

THE COURT: Mr. Burnett, and he paid more for the insurance than he would have paid, but apparently he got the best deal he could, and the fact that he was a member of the group, the majority of which chose to make a charitable contribution, I just don't think that that made him a charitable contributor. He was buying insurance, the best deal he could get, and without—

[3603] MR. THROWER: As to Burnett, our position would be that as a member of the group the Burnetts are entitled to participate in this group gift in the same way as others. If they did not participate, then the participation of those with an average risk or better than average risk, their participation in the gift would be larger, because the group gift remains the same, but because the group itself could in any year by a group decision reduce the net cost for every member of the group, including the Burnetts, it seemed to us that each member should participate.

Otherwise, if you went to a subjective position on that basis, those in good health and better risk would have a great part of this group gift when you eliminated the Burnetts in the high risk.

THE COURT: Mr. Thrower, I understand your argument, I really do. I simply don't find the model classification. It may be up to the Court of Appeals to come up with—

MR. THROWER: Well, we do appreciate your attention to it.

THE COURT: I understand well enough, and I do find it persuasive in the context of whether this is a business or not. I think that one can as a group make a decision not to operate something as a business, to allow high premiums to be charged voluntarily, and that that does not then render what the revenues, the net revenues as being profit. That far I am [3604] willing to go. This concept of a group gift, I just don't think we have a model for it, Mr. Thrower. I think this would be the first case. We would have to resort to something like the Section 79 tables, which is something Congress specifically thought about and legislated, and I like to think of myself as fairly daring and imaginative, but my daring and my imagination has boundaries.

I'm willing to make all of the findings you wish to set up the issues for appeal. I think these are important issues, and obviously they are going to be decided on appeal, and you have my sympathy. I simply have to follow the law as I see it, and with appropriate limitation of my discretion given that I'm a trial judge and not an appeal judge.

For what it is worth, I recognize that all of the facts you have stated, or all of the things you have presented are, in fact, true. The Endowment could have set the rates lower, it set rates higher—and in fact it is required from an earlier decision—it sets rates higher by a democratic majority

process which could have been changed by—I specifically find could have been changed from year to year if there were an impetus for it.

I found that there is no reason to believe that the American Bar Association processes are such that they would not be susceptible to democratic change. On the contrary, I would expect they would be, and that, in fact, by consent of the [3605] majority, and probably overwhelming majority of the members, this enterprise has been run in a non-business fashion in a way which would be to the general detriment of the group as a whole for the benefit of the association.

Equating that into a group gift for purposes of getting a charitable deduction, I just cannot take it that far.

MR. THROWER: That is where we part, yes. But we understand your position. Thank you, Your Honor, we do appreciate your attention to the case, we know you have given it a lot of thought.

THE COURT: I was going down the list. If there is anything else that needs to be addressed—let's see, item A. 2. on page 4:

"Is the quid pro quo or private financial benefit received by the insured members from their participation payments properly measured by the net cost of the insurance (gross premiums less dividends or experience credits) plus related expenses or is it measured by the gross premium paid to the insurance companies?"

I never understood that question. Does anybody want me to answer that question? I will try to bisect it for you—I mean, is anybody—Mr. Rubloff?

MR. RUBLOFF: Your Honor, I have the uncomfortable feeling that perhaps I have prodded the Court into responding specifically at this point in time to these questions, when I [3606] really didn't intend—

THE COURT: I'm not going to go down and make specific findings of fact, I'll write an opinion, so if there are specific points you want me to hit, you want to be sure that I hit, I think this is the time to ask me. Now, I might cover them in any case, but I might not.

MR. RUBLOFF: Well, Your Honor, my question is that the Court has in the course of its comments on the resolution of the various cases effectively resolved all of the disputed issues of fact, and I find it somewhat troublesome to impose upon the Court now the burden of having to respond to two separate sets of questions posed by the parties, each of which would understandably be posed in such terms as to perhaps favor their respective positions, or to generate an answer to their liking.

So for the Government's part, I am perfectly content if the Court would prefer to defer making any findings at this time and would simply incorporate its findings in its opinion, with the wareness [*sic*] that the parties are interested in the resolution of the subject matter raised by each parties' questions.

THE COURT: That's fine with me. I mean, I don't understand all of the questions, and maybe if I get back into it I would just as soon not go through it. So I take it you are equally unhappy with the case by case approach as Mr. [3607] Thrower is?

MR. RUBLOFF: Yes, Your Honor. I feel that you have correctly stated the law with respect to the resolution of the individual plaintiffs' cases.

THE COURT: No, my question was, I assume you are equally unhappy about the case by case approach? Mr. Thrower seems to think that that would be unworkable. I think it is unworkable.

MR. RUBLOFF: Well, I don't know if it is appropriate for me to express my personal opinion. I think you have properly stated the law with respect to the individual cases, and I think you have properly applied the law to the facts of those particular cases.

THE COURT: But you understand, Mr. Rubloff, when I come out with the writing I will allow for the possibility that 75,000 members can come in here and make a case that they made a contribution, and if they make that showing, if I'm correct in my ruling, they will win.

MR. RUBLOFF: I understand that, Your Honor.

THE COURT: I don't know how happy you are with that.

MR. RUBLOFF: Well, I don't think I'm unhappy, this is really irrelevant.

THE COURT: It doesn't thrill me.

MR. RUBLOFF: I don't think that my happiness is really relevant. I think my function is to ensure that the law [3608] is properly applied, and I do believe that is the case here, and we will just have to take each case as it arises.

THE COURT: Well, I have had three trials since this case finished. I have a two-week trial in January, so don't look for anything before February. I have things to do and places to go, and I do think the case is important and needs to be resolved, and I will write something because obviously many of the issues, at least some of the issues are—and I will try to do as fair and as clear a statement of what I'm deciding as possible so as to give the Appellate Court an opportunity to reverse it or whatever. I'm not pulling any rabbits out of the hat, I'm trying to be mindful of the position of both parties, and include in my statement of facts as much as I think the parties would want and need in order to make their case on appeal. No doubt the case is going to go on appeal.

I should say though that what I have said here on the record, and what I said the last time on the record, are my findings, and if anything is not included in the opinion it should be—if anything I have stated on the record is not included in the opinion, that should be viewed as a finding of fact, and can be used for purposes of appeal.

Let me now for the last time, and this is, I think, the last time we're going to probably meet before I issue an opinion, let me encourage the possibility of settlement. I [3609] know people have tried, you know a little bit more now. I have no idea what went on before. You have a little bit more, pieces of information, and since nothing is going to be forthcoming from me, at least until February, I just cannot do it, it is simply not possible, go back and reflect, factor in additional information and don't be bashful.

There is plenty of room for me to be wrong on both issues. I think this is a difficult case, I think this is an unusual case, and I think it is a case where the outcome on appeal is highly in doubt. So now you know a little bit more.

You know, I am only sorry I was not able to come up with something in the case of the individual plaintiffs that I could live with and that would take care of things in a more blanket fashion. I am not terribly happy about this way of resolving the case, but I guess I did the best I can, and let people with greater authority to do more.

I would suggest, on the basis of what my comments have been, and on the greatest likelihood that I will not change my mind, and I think it is very clear I will not change my mind, I would like you all to work out a stipulation with the amount of judgment in the Endowment case, because my opinion will require you to file one, because I assume nobody is going to want me to go through the ledgers and figure out the dollars and cents. Yes?

MR. GREGORY: It has been stipulated, Your Honor.

* * * * *

0170.00-00

CC: I-4119
Br5:DMRoth

G.C.M. 36713

April 20, 1976

JOHN L. WITHERS
Assistant Commissioner (Technical)
Attention: *Director, Individual Tax Division*

In a memorandum dated January 13, 1976, the Individual Tax Division (T:I:I:1:3) requested that this Office reconsider the position expressed in several G.C.M.'s that the "detached and disinterested generosity" concept enunciated by the Supreme Court in *Commissioner v. Duberstein,* 363 U.S. 278 (1960), should not be applied with respect to the deduction of charitable contributions under *Int. Rev. Code of 1954,* § 170 [hereinafter cited as *Code*]. *See, e.g.,* G.C.M. 36360, _____I-72-74 (Aug. 6, 1975); G.C.M. 35251, _____, I-5114 (Feb. 26, 1973); G.C.M. 34956, _____, I-4771 (July 20, 1972), *considering before publication* Rev. Rul. 72-506, 1972-2 C.B. 106; G.C.M. 34863, _____, I-4119 (April 28, 1972). The Individual Tax Division indicated concern that the Government was continuing to rely on the *Duberstein* "detached and disinterested generosity" concept in cases involving *Code* § 170 even though this Office has taken the position that such reliance is not appropriate.

This document is not to be relied upon or otherwise cited as precedent by taxpayers.

Although there have been instances in which Government attorneys have cited *Duberstein* in *Code* § 170 cases, we do not believe that there is any disagreement within this Office with respect to the position set forth in the G.C.M.'s cited above. We have coordinated this matter with our Refund Litigation and Tax Court Litigation Divisions and have been advised that both divisions are in agreement with that position and are not recommending or approving use of the *Duberstein* concept in *Code* § 170 cases. We agree with the Individual Tax Division that it is important to maintain a consistent position in *Code* § 170 cases in litigation and hope that inadvertent reliance on *Duberstein* can be avoided in the future. It appears, however, that because there is no disagreement with the position taken in the G.C.M.'s cited above, reconsideration of those memoranda is not warranted at this time.

MEADE WHITAKER
Chief Counsel

By: /s/ JAMES F. MALLOY
JAMES F. MALLOY
Technical Assistant to the
Division Director
Interpretative Division

Supreme Court of the United States

No. 85-599

UNITED STATES, PETITIONER

v.

AMERICAN BAR ENDOWENT, ET AL.

ORDER ALLOWING CERTIORARI. Filed December 2, 1985.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Federal Circuit is granted.

Justice Powell and Justice O'Connor took no part in the consideration or decision of this petition.

U.S. GOVERNMENT PRINTING OFFICE 1986—491 507/20515